THE UNIVERSITY OF ALBERTA

THE EVOLUTION OF PETROLEUM CONCESSIONS IN IRAN AND ALBERTA

by

© M. D. Cullen

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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research, for acceptance, a thesis entitled, "The Evolution of Petroleum Concessions in Iran and Alberta", submitted by Mark D. Cullen in partial fulfilment of the requirements for the degree of Master of Laws.

Supervisor

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Date April 8, 1981

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ABSTRACT

An analysis of petroleum concession agreements granted by Iran and Alberta to investors was conducted to investigate the effect of barganing position upon the terms of the agreements. Petroleum concessions granted by Iran from 1901 to 1973 and concessions granted by Alberta from 1947 to 1976 were examined. Although Iran and Alberta are desparate states, with different social, political and econimic systems, the terms contained in the agreements made by each are markedly similar.

Iran granted its first concession in 1901 and the terms thereof were markedly in favour of the invester. This fact is explained by the dificult economic position Iran faced and the political influence of the invester. The terms of successor agreements to the 1901 concession remained favourable to the investor until 1973 when petroleum became a scarce commodity.

Alberta granted its first concession in 1931 and this agreement likewise favoured the investor. This fact is again related to economics for in 1931 Alberta faced an economic crisis brought on by the Great Depression and petroleum in commercial quantities had yet to be discovered. After the discovery of commercial quantities of petroleum in 1947, the position of the Alberta government strengthened. The energy crisis of 1973 further solidified the position of the Alberta government.

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Chapter 1

Petroleum Concession Agreements

This thesis will examine the development and the history of petroleum concession agreements in Iran[1] and Alberta [2] until 1973. Despite the political, social and economic differences between Iran and Alberta, there have been changes in the relationship between the oil companies and the respective states which parallel each other. These parallels would seem to have been reflected in the types of contracts which both Iran and Alberta made from time to time with their oil companies.

In simple terms, a petroleum concession is a contract between the owner of the resource as grantor and the investor-developer as grantee. Usually the state is in the position of grantor because the mines and minerals in most states are owned by those states.[3] The purpose of the new contract is the development of a particular resource. The investor-developer is granted the right to develop the resource in return for the payment of certain sums to the owner.

Petroleum concessions, like the people who create them, have stages of development. These stages can be described in general terms. In the early stage, three characteristics are generally present. First, the concession areas are usually large, generally because no one really knows where the resource, if any, can be found within the boundaries of the state.[4]

Second, rights to the concession area are often granted to the investor-developer for a relatively long period of time.[5] The lengthy term of a petroleum concession is explained by the fact that the resource must be found, transported, refined, and marketed. These factors necessitate that the term of a petroleum concession must be of a long duration.

Third, the financial returns to the owner are generally relatively modest.[6] The investor-developer is required to expend a great deal of money to find, develop, and market the petroleum. The modest return to the state is an acknowledgement of the risk taken by the investor-developer.

Some authorities on developmental economics, including Mikesell,[7] Tanzer,[8] and Moran,[9] have attempted to explain why early concession contracts are so favourable to the investor-developer and so unfavourable to the state owner of these resources. The above authorities provide at least five explanations to account for this situation. First, the exploitation of natural resources is often the only means by which a state can obtain the money necessary to industralize. The state can either invite development of its natural resources or remain economically stagnant. Second, the state is unable itself to afford the very great risk involved in searching for and developing its natural resources.[10] This factor of risk is always of particular significance in relation to petroleum because an equity poor country cannot risk tis available reserves of capital in the search for a substance that might not exist within its boundaries.[11] Third, the state cannot wait to receive a return on its investment which, if it comes at all, will accrue over the long term and only when the project is actually on-line.[12] Fourth, the state needs the technology and expertise often possessed only by international companies.[13] Fifth, the state often lacks access to international markets and is incapable of stabilizing prices of the commodity exported.[14]

Because of the above factors, a prospective investor-developer is faced with a venture that involves extraordinarily high risk. A decent rate of return is necessary to encourage the initial risk-taking and promote further risk-taking. As a result of the high risk, the investor and not the state is able to dictate the terms of the petroleum concession agreement, a privilege which seems to continue until commercial production has been achieved.

Once commercial production has been achieved, however, the second stage in the relationship between the state and the investor-developer is soon reached. At this stage, both parties to a concession agreement have an equal interest that the production of petroleum be continued. The state derives its budget from the oil revenues, and the oil company derives substaintial profits from the exploitation of the resource. The state at this stage depends for its income upon the investor-developer's expertise and marketing ability. It is important to note that at this stage the relationship between the parties is interdependent, and neither is in a dominant position.

Gradually, the third stage in the relationship is reached. This occurs when the state is in a position financially and politically to assert a dominant position as owner of the resource.[15] Only then is it able to maximize the benefits from its natural resources.

In this thesis, the concession agreements granted by Iran and Alberta will be analyzed. It is hypothesized that the early concessions granted by each state will show the dominant position of the oil companies but that the latter agreements will reflect an improvement in the bargaining positions of the respective states.

Footnotes Chapter 1

1. Persia's name was changed to Iran in the 1930's by Reza Khan. For convenience, the name Iran is used throughout this thesis.

2. The province of Alberta is used as a focus of analysis and not Canada as the oil industry of Canada is situated in Alberta.

3. In Iran all mines and minerals are owned by the central government. In Alberta, approximately 85% of mines and minerals are owned by the provincial government having been acquired from Ottawa in 1930.

4. The petroleum concession granted by Iran to William D'Arcy in 1901 covered an area of 500,000 square miles (Article 1 of the D'Arcy Concession). In Alberta, in 1931, the area of a single petroleum and natural gas lease was 1,920 acres, although there was no limit on the number of leases a single company could hold. (Petroleum And Natural Gas Regulations, Alta. Reg. 669/31).

5. The D'Arcy Concession was to continue for a term of 60 years by virtue of Article 1 of the D'Arcy Concession. In Alberta, by virtue of the Petroleum And Natural Gas Regulations, Alta. Reg. 669/31, the term of a lease was twenty-one years which was renewable for an additional twenty-one years.

6. Later modifications to the D'Arcy Concession provided the host state with a return of four shillings gold per ton of petroleum extracted or approximately seven cents per barrel. This figure is based on calculations made by the Saudi government whose return was the same during this period. See A.Z. Yamani, "The Oil Industry in Transition" (1975) 8 Natural Resources Lawyer 393.

Under the Alberta Regulations of 1931, the Provincial government was to receive 5% of sales or approximately 10 cents per barrel. Oil in 1931 sold for approximately $2.00 per barrel. In fact, the price of oil remained static until the late 1960's. See Z. Mikdashi, A Financial Analysis of Middle Eastern Concessions: 1901-1965 (1966) 97.

7. R. Mikesell, "The Contribution Of Petroleum And Natural Resources To Economic Development" Foreign Investment In The Petroleum And Mineral Industries (1971).

8. M. Tanzer, The Political Economy Of International Oil and the Underdeveloped Countries (1971).

9. T. Moran, "The Evolution of Concession Agreements In Underdeveloped Countries and the U.S. National Interest" (1973-1974) 7 Vanderbilt Journal of Transnational Law.

10. Tanzer, The Political Economy of International Oil and the Underdeveloped Countries, supra n. 8 at 117

11. An equity poor country would be one with insufficient reserves of foreign exchange. Foreign exchange is necessary to procure both foreign experts and equipment with which to conduct oil operations.

12. Moran, "The Evolution of Concession Agreements In Underdeveloped Countries and the U.S. National Interest" (1973-1974) 7 Vanderbilt Journal of Transnational Law, supra n. 9 at 321.

13. W. Loehr, "The Uneasy Case For Foreign Investment In Developing Countries" (1972) 2 The Denver J. of International Law and Policy 188.

14. Until the Arab oil embargo of 1973, it is arguable that no Middle Eastern state was capable of marketing its petroleum without the assistance of the major oil companies. Support for this proposition is found by examining the aftermath of the Iraqi nationalization of the Iraqi Petroleum Co. in 1972. In response to the nationalization, an embargo was placed upon Iraqi crude oil by the international oil companies. Because of the embargo, the quantity of crude oil sold by Iraq diminised and Iraq was forced to cut its 1972 budget by 40%.

15. Conditions favourable to the investor-developer were present in both Alberta nad Iran prior to 1976. A surplus of crude oil existed world wide and the international companies were able to impose their contractual conditions upon both states. After the Middle East oil embargo of 1973, the price of oil was determined by the producing states themselves. This situation resulted because of the increased demand for petroleum and insufficient supplies of petroleum. Each state has derived sufficient oil revenue to diversify its economy. This transition was more difficult for Alberta, however, because of its distance from major markets. The financial return from the ownership of petroleum and natural gas resources is now large and immediate. There is no longer such a substantial risk involved in searching for petroleum in either Iran or Alberta, for petroleum is now a proved resource in both states. Each state is capable of purchasing the required technology and expertise for oil exploration programs. Finally, there is no longer any difficulty in marketing the petroleum produced.

Chapter 2

The Iranian Concession: 1901-1951

The original concession agreements reached between Middle Eastern countries and the international oil companies have been described as classic examples of contracts resulting from an imbalance of power.[1] This generalization seems true with respect to the D'Arcy Concession of 1901, the first major petroleum concession entered into by Iran.

The D'Arcy Concession

The D'Arcy Concession was granted by Shah Muzaffar ed-Din to William D'Arcy, and English national, on May 28, 1901. The D'Arcy Concession was granted against "a background of decay in the central authority, social unrest, corruption of the administration, mortgaged national resources, foreign political interference and arbitrary rule of ignorant leaders.[2]

In short, Iran suffered from all of the economic disadvantages commonly found in underdeveloped countries wishing to develop their natural resources. In addition, it seemingly had very little to offer a prospective investor-developer. There were but three producing oil wells in the entire country,[3] and petroleum in commercial quantities had not yet been discovered. Moreover, there was an overabundant supply of oil in the world and more atractive places for investment. Although William D'Arcy ultimately chose to invest in Iran, he did so on his own terms. This agreement with Iran, as one would expect, clearly indicates that country's lack of bargaining power.

The Text of the D'Arcy Concession

The text of the D'Arcy Concession is very short and, for convenience, is quoted here:[4]

Between the Government of His Imperial Majesty the Shah of Persia of the one part and William Knox D' Arcy of independent means residing in London at No. 42 Grosvenor Square (hereinafter called "the Concessionnaire") of the other part.

The following has by these presents been agreed on and arranged, viz.:

ARTICLE I

The Government of His Imperial Majesty the Shah grants to the Concessionnaire by the presents a special and exclusive privilege to search for, obtain, exploit, develop, render suitable for trade, carry away and sell natural gas, petroleu, asphalt and ozokerite throughout the whole extent of the Persian Empire for a term of 60 years as from the date of these presents.

ARTICLE 2

This privilege shall comprise the exclusive right of laying the pipelines necessary from the deposits where there may be found one or several of the said products up to the Persian Gulf, as also the necessary distributing branches. It shall also comprise the right of constructing and maintaining all and any wells, reservoirs, stations and pump services, accumulation services and distribution services, factories and other works and arrangements that may be deemed necessary.

ARTICLE 3

The Imperial Persian Government grants gratuitously to the Concessionnaire all uncultivated lands belonging to the State which the Concessionnaire's engineers may deem necessary for the construction of the whole or any part of the above-mentioned works. As for cultivated lands belonging to the State, the Concessionnaire must purchase them at a fair and current price of the Province.

The Government also grants to the Concessionnaire the right of acquiring all and any other lands or buildings necessary for the said purpose with the consent of the proprietors, on such conditions as may be arranged between him and them without their being allowed to make demands of a nature to surcharge the prices ordinarily current for lands situate in their respective localities. Holy places with all their dependencies within a radius of 200 Persian archines are formally excluded.

ARTICLE 4

As three petroleum mines situate at Schouster Kassre-Chirine in the Province of Kermanschahan and Daleki near Bouchir are at present let to private persons and produce an annual revenue of two thousand tomans for the benefit of the Government, it has been agreed that the three aforesaid mines shall be comprised in the Deed of Concession in conformity with Article 1, on condition that over and above the 16 per cent mentioned in Article 10 the Concessionnaire shall pay every year the fixed sum of 2,000 (two thousand) tomans to the Imperial Government.

ARTICLE 5

The course of the pipelines shall be fixed by the Concessionnaire and his engineers.

ARTICLE 6

Notwithstanding what is above set forth, the privilege granted by these presents shall not extend to the Provinces of Azerbadjan, Ghilan, Mazendaran, Asdrabad and Khorassan, but on the express condition that the Persian Imperial Government shall not grant to any other person the right of constructing a pipeline to the southern rivers or to the south coast of Persia.

ARTICLE 7

All lands granted by these presents to the Concessionnaire or that may be acquired by him in the manner provided for in Articles 3 and 4 of these presents, as also all products exported shall be free of all imposts and taxes during the term of the present Concession. All material and apparatuses necessary for the exploration, working and development of the deposits and for the construction and development of the pipelines shall enter Persia free of all taxes and custom-house duties.

ARTICLE 8

The Concessionnaire shall immediately send out to Persia and at his own cost one or several experts with a view to their exploring the region in which there exist, as he believes, the said products, and in the event of the report of the expert being in the opinion of the Concessionnaire of a satisfactory nature, the latter shall immediately send to Persia and at his own cost all the technical staff necessary with the working plant and machinery required for boring and sinking wells and ascertaining the value of the property.

ARTICLE 9

The Imperial Persian Government authorizes the Concessionnaire to found one or several companies for the working of the Concession.

The names, "statues" and capital of the said companies shall be fixed by the Concessionnaire, and the directors shall be chosen by him on the express condition that on the formation of each company the Concessionnaire shall give official notice of such formation to the Imperial Government through the medium of the Imperial Commissioner and shall forward the"statutes" with information as to the places at which such company is to operate. Such company or companies shall enjoy all the rights and privileges granted to the Concessionnaire, but they must assume all his engagements and responsibilites.

ARTICLE 10

It shall be stipulated in the contract between the Concessionnaire of the one part and the Company of the other part that the latter is within the term of one month as from the date of the formation of the first exploitation company to pay the Imperial Persian Government the sum of 20,000 sterling in cash and an additional sum of 20,000 sterling in paid-up shares of the first company founded by virtue of the foregoing Article. It shall also pay the said Government annually a sum equal to 16 per cent of the annual net profits of any company or companies that may be formed in accordance with the said Article.

ARTICLE 11

The said Government shall be free to appoint an Imperial Commissioner who shall be consulted by the Concessionnaire and the directors of the companies to be formed. He shall supply all and any useful information at his disposal and he shall inform them of the best course to be adopted in the interest of the undertaking. He shall establish by agreement with the Concessionnaire such supervision as he may deem expedient to safeguard the interest of the Imperial Government.

The aforesaid powers of the Imperial Commissioner shall be set forth in the "statutes" of the companies to be created.

The Concessionnaire shall pay the Commissioner thus appointed an annual sum of 1,000 sterling for his services as from the date of the formation of the first company.

ARTICLE 12

The workmen employed in the service of the Company shall be subjects of His Imperial Majesty the Shah, except the technical staff such as the managers, engineers, borers and foremen.

ARTICLE 13

At any place in which it may be proved that the inhabitants of the country now obtain petroleum for their own use, the Company must supply them gratuitously with the quantity of petroleum that they themselves got previously.

Such quantity shall be fixed according to their own declarations subject to the supervision of the local authority.

ARTICLE 14

The Imperial Government binds itself to take all and any necessary measure to secure the safety and the carrying out of the object of this Concession, of the plant and of the apparatuses of which mention is made for the purposes of the undertaking of the Company. The Imperial Government having thus fulfilled its engagements, the Concessionnaire and the companies created by him shall not have power under any pretext whatever to claim damages from the Persian Government.

ARTICLE 15

On the expiration of the term of the present Concession, all materials, buildings and apparatuses then used by the Company for the exploitation of its industry shall become the property of the said Government, and the Company shall have no right to any indemnity in this connection.

ARTICLE 16

If within the term of two years as from the present date the Concessionnair shall not have established the first of the said companies authorized by Article 9 of the present Agreement, the present Concession shall become null and void.

ARTICLE 17

In the event of there arising between the parties to the present Concession any dispute or difference in respect of its interpretation or the rights or responsibilities of one or the other of the parties therefrom resulting, such dispute or difference shall be submitted to two arbitrators at Teheran, one of whom shall be named by each of the parties, and to an Umpire who shall be appointed by the arbitrators before they proceed to arbitrate. The decision of the arbitrators or, in the event of the latter disagreeing that of the umpire, shall be final.

ARTICLE 18

This Act of Concession made in duplicate is written in the French language and translated into Persian with the same meaning.

But in the event of there being any dispute in relation to such meaning, the French text shall alone prevail. Teheran Sefer 1319 of the Hegire, that is to say May 1901.

(Signed) WILLIAM KNOX D'ARCY

By his Attorney,

*(Signed)*ALFRED L. MARRIOT.

Certified that the above signatures were affixed in my presence at the British Consulate General at Gulaket near Teheran, on this 4th day of the month of June 1901 by Alfred Lyttelton Marriott, Attorney of William Knox D'Arcy in accordance with the Notarial Act dated 21st March 1901, and seen by me.

(Signed) GEORGE GRAHAM
Vice-Consul.

The point was made in the first chapter of this thesis that in terms of area, duration, and financial returns to the owner, early concession agreements were heavily weighed in favour of the investor-developer. All of these characteristics were present in the D'Arcy Concession.

Area

In terms of area, William D'Arcy was granted 500,000 square miles.[5] Iran, by Article 6 of the D'Arcy Concession, expressly excluded the northern provinces from the area of the concession. However, the site of the richest deposits of petroleum was in southern Iran. The value of the grant was assured and enchanced by Article 2 of the D'Arcy Concession which gave William D'Arcy "the exclusive right of laying the pipelines necessary from the deposits ... to the Persian Gulf" and by Article 6 of the concession which precluded Iran from granting "any other person the right of constructing a pipeline to the southern rivers or to the south coast of Persia." Since the only means by which any petroleum located elsewhere in the country could be exported economically was by way of the Persian Gulf, the grant of this exclusive right to construct pipelines enabled D'Arcy to prevent competition.

The pipeline provisions in the D'Arcy Concession were also of considerable political significance. In effect, they gave D'Arcy, an Englishman, the right to exclude other investor-developers from Iran and allow Britain, through him, to consolidate its position in that country. For example, in 1907, Russia obtained a zone of influence in northern and central Iran, but she was precluded from exploiting the petroleum resources in those areas because she could not build a pipeline to the Persian Gulf. As we shall see, England's influence in Iran after 1907 increased markedly.[6]

Duration

The D'Arcy Concession was continued for a period of sixty years by virtue of Article 1 of the agreement. Furthermore, one should note that the agreement contained no clause upon which an early termination of the agreement could be based.

Financial Returns to Iran

Articles 9 and 10 of the concession agreement contained the financial provisions. Article 9 of the agreement permitted D'Arcy to form one or more companies for the working of the concession. The company or companies formed were to assume all of D'Arcy's obligations under the concession agreement.

Article 10 outlined what these obligations were to be. D'Arcy was to pay Iran the sum of £20,000 within one month of the formation of the first company and he was to provide Iran with £20,000 worth of paid up shares in that company.[7]

Initially, both parties were content with annual payments based on a fixed percentage of the annual net profits of each company formed for the working of the concession. This mode of payment would benefit D'Arcy if he derived little or no profit from the concession.[8] It would not be so profitable if he were required to pay a fixed sum of money per barrel of oil extracted--for his expenses might well exceed the income derived from the sale of that oil. From Iran's point of view, a percentage of the net profits would be more advantageous if the venture were as successful as she hoped it would be.[9]

One of the problems between the parties was caused by the fact that the venture was both less and more successful that expected. From 1901 to 1907, when oil in commercial quantities was discovered, there was no profit at all. After 1908, the profits were enormous and bore no relationship to either D'Arcy's investment or the risk he was assuming. Iran, however, continued to receive a relatively small percentage of the income.

Of more concern to the Iranians, however, was what they perceived to be an illegitimate attempt on the part of D'Arcy and those claiming through him to reduce even the small percentage of the profits to which they were entitled. The source of this problem was Article 9, in which Iran permitted D'Arcy to form "one or several companies for the working of the concession," and Article 10 which required D'Arcy to pay to Iran an annual sum equal to 16 per cent of the annual net profits of any company or companies he formed.

Strictly speaking, the only companies that could "work" the concession were those formed to operate within the boundaries of the concession in Iran. D'Arcy and those claiming under him, however, also formed several subsidaries for the purpose of shipping, processing, and marketing the petroleum extracted from the concession. These companies operated outside of Iran; and from D'Arcy's point of view at least, the significant profits of these companies did not form part of the profits for which the 16 per cent royalty was to be paid.

It is impossible at this time to determine whether Articles 9 and 10 were so worded at D'Arcy's insistence and for his protection or were simply the product of poor draftsmanship. The former explanation is not at all unreasonable, when one has regard to certain of the other terms which have been discussed. There is no doubt at all, however, that the following terms were included for the benefit of D'Arcy as a result of his strong bargaining position.

Other Significant Terms of the Concession

By Article 14, the Iranian government bound "itself to take all and any necessary measures to secure the safety and the carrying out of the object of this Concession ..., and to protect the representatives, agents and servants of the Company." In return, once the Iranian government fulfilled these obligations, the "Concessionnaire and the companies created by him shall not have power under any pretext whatever to claim damages from the Persian government."

Such a provision would not be surprising in an agreement between a modern state with a stable government and an investor-developer. The power of the centeral government in Iran, however, did not extend throughout the country, most of which , in fact, was controlled by a number of local sheikhs.[10] The fact is that the government of Iran was powerless to protect D'Arcy. Therefore, when his operations were damaged in anyway, as they often were, he had a claim against the government. As a result of many of these claims, he gained even further concessions.

Article 15 was less significant in the relationship of the parties but it, too, reflected either poor draftsmanship or the unequal bargaining power of the parties. Article 15 of the concession stated that on "the expiration of the term of the present Concession, all materials, buildings and apparatuses then used by the Company for the exploitation of its industry shall become the property of the said Government, and the Company shall have no right to any indemnity in this connection." This provision was obviously designed to allow Iran to take over the concessionnaire's property at the end of the concession. The difficulty with Article 15 is that its language clearly required the materials, buildings and apparatuses to be on site and in use at the end of the concession if Iran was to claim them. If the equipment were not "then used" because the concessionnaire had removed it, Iran would be entitled to nothing.

Finally, Article 16 required D'Arcy to form a company to develop the concession within two years from the date of the agreement. This term was D'Arcy's sole duty under the agreement. It was thus possible for D'Arcy not to develop the concession yet to hold all rights for the exploitation of the concession for a period of sixty years. There fore, if D'Arcy had chose to do nothing, Iran would have been deprived of any revenue from its most precious natural resources for a considerable period of time.

On the basis of the above analysis, it is submitted that the D'Arcy Concession was much more favourable to D'Arcy that to Iran. Admittedly this inequity may have been caused by poor draftsmanship and certainly, as we will see later, Iran expected to receive much more from the concession that she actually did receive. On the other hand, would it be reasonable for one to assume that the ill-considered words of a draftsman would always favour the one party rather than the other? What is clear, however, is that in terms of the area and the duration of the concession, Iran stood to make but a modest sum--as little as £20,000 if D'Arcy chose not to exploit the rights he was given.

What was perhaps hidden from the parties themselves was the fact that the D'Arcy Concession was of considerable political significance. It is not overstating the case to say that the provisions relating to pipelines in that agreement allowed Britain to acquire an influence in Iran that would continue to increase until 1951.

The D'Arcy Concession: 1905 - 1912

D'Arcy began to drill shortly after the concession agreement was signed, but it soon became apparent that he would have to obtain financing if he were to take full advantage of the rights he had been given. He looked first to financiers in London.[11] When none of them appeared interested, he sought the money from foreign capitalists. It was only then that the British government began to take an interest and to realize how, if properly exploited, the concession could be used to advance British interests in the Middle East. D'Arcy's taking of a foreign partner could jeapordize those interests. Accordingly, the First Sea Lord, Sir John Fisher, persuaded Lord Strathcona of Burmah Oil Company Limited (hereafter Burmah Oil) to negotiate with D'Arcy for the purpose of providing the financing he required.[12] As a result of these negotiations, D'Arcy and Burmah Oil formed the Concessions Syndicate Limited in May of 1905.

The relationship between D'Arcy and Burmah Oil continued until petroleum was discovered in commercial quantities at Masjid-i-Sulaiman in 1908. As a result of this discovery and the need for an ever greater amount of capital, Anglo-Persian Oil Company, Limited (hereafter Anglo-Persian) was incorporated on April 41, 1909, with an initial capitalization of ₤2,000,000, the majority of which was provided by Burmah Oil.[13]

When commercial production was obtained, the British Admiralty once again took an interest in the concession—this time for a different but equally political reason. The British fleet was being modernized and oil was required to replace coal as a source of fuel.[14] The British had no indigenous source of oil and were thus forced to rely upon Standard Oil and the Royal Dutch Shell Company for petroleum products. The political implications of a world-power's relying upon foreign companies for oil are clear.

In order to assure supplies of petroleum in times of crisis the British Admiralty, under the direction of Winston Churchill, signed a twenty year supply contract with Anglo-Persian and agreed to acquire a majority interest in the company for £2,200.000.[15] Therefore, by 1914 and the begining of the First World War, the British government found itself in control of a concession which was to become one of the most profitable in the Middle East.

Difficulties Between the Parties

Anglo-Persian had no difficulties with the Iranian government until 1915. In February of that year, however, the company's pipelines were cut by Bakhtiari tribesmen. When the company submitted a claim to the Iranian government for £160,000, which it was entitled to do under Article 14 of the concession agreement, the Iranian government refused to pay.[16]

Article 17 of the concession agreement required that all disputes between the parties be settled by arbitration. Instead the company from 1915 to 1919 ceased payment of the government's share of the net profits which would have amounted to one million pounds sterling. The strain in the relationship between the parties that this caused is noted in a reference by the Iranian Minister of Foreign Affairs in a note submitted in 1932 to the British government regarding this event:

> Although, during the Great War, the price of oil and of oil products constantly rose and the demand grew greater (Persian oil being considered as an important factor in the Allied fleets); and although the sale of Persian oil at world rates brought the company enormous profits, the Company, despite the explicit terms

> of the Concession, failed to pay the Persian Government the sums which were its due, thus, in practice, completely invalidating the agreement.[17]

Another reference to this failure to pay the Iranian government its share of net profits was made in a communication to the International Court of Justice by the Minister for Foreign Affairs of Iran:

> The said company, under various pretexts, did not make any royalty payments to the Iranian Government until the year 1919; and paid no attention to the requests of the said Government to refer the said dispute to arbitration.[18]

A second disagreement between the parties arose because of Anglo-Persian's attempts to minimize its net profits and thereby the amounts to be paid to Iran. One example of this minimization may be seen by considering the contract between the company and the British Admiralty. After the British government acquired its controlling interest in Anglo-Persian, the price of fuel oil supplied to the Admiralty fell from 3 pounds 15 shillings per ton to 2 pounds sterling per ton.[19] This represented a cumulative saving to the Admiralty estimated by Iranian sources at $500 million U.S. and a loss to the Iranian government of an estimated $60 million U.S. While the contract with the Admiralty did provide a market for Iranian crude oil, it did so at the expense of the Iranian government. It would seem that an assured supply of crude oil from a concession controlled by private British subjects would have been attractive to the Admiralty even at 3 pounds 15 shillings per ton.

Another way in which the company sought to minimize the net profits subject to royalties has already been described. This related to the company's practice of forming subsidiary companies to carry on operations outside of Iran. It will be remembered that Article 9 gave D'Arcy and those claiming under him the right to found one or several companies for the working of the concession. It said nothing about companies formed for purposes other than working the concession and intended to function outside of Iran. Nor did Article 10 which required the concessionnaire to pay Iran an annual sum equal to 16 per cent of the annual net profits of any company or companies formed pursuant to Article 9. On a strict interpretation of these Articles, the concessionnaire was not required to pay a royalty on any profits earned by companies outside of Iran..

Whether Anglo-Persian deliberately chose to found subsidiary companies for the purpose of minimizing the payments to Iran can never be known. It seems as possible that any concessionnaire would wish to form additional companies for the purpose of protecting himself financially and to achieve legal and financial flexibility. These are legitimate business purposes.

Whatever the company's purpose might have been, the fact remains that Anglo-Persian did not pay royalties on the substantial profits made by its subsidiaries. The Iranians would have been less than human if they had failed to note with covetous eyes the enormous profits made by refineries provided with Iranian oil, marketing facilities using Iranian oil, and tanker companies transporting Iranian oil.[21] It was Iranian oil and the Iranians, quite rightly, felt cheated.

The Iranian government expressed its perception of the situation in this manner:

> It (Anglo-Persian) has also refused, contrary to the express conditions of the contract, to pay the Persian Government its share of the profits earned by its subsidiaries. It has further granted to some of its subsidiaries large subsidies taken from its profits, including these sums in its accounts as expenditures and thus appreciably diminishing the Persian Government's share.[22]

Most of the above difficulties can be attributed to the fact that the D'Arcy Concession was becoming profitable. There were no difficulties at all when D'Arcy was involved in expensive exploration programs and risking more money than he might ever recover. At that time he was perceived to be working both for himself and Iran. If unduly troubled, he might have chosen to leave. But the situation changed when the concession became profitable and under no circumstances did D'Arcy wish to forfeit such a valuable asset—even if the terms thereof were changed.

The financial difficulties between the company and Iran were temporarily resolved by the Armitage-Smith Agreement of December 22, 1920. The terms of this agreement show that a shift in bargaining power had begun.[23]

The text of the Armitage-Smith Agreement is found in Schedule A.

The Problem Which the Armitage-Smith Agreement Was to Resolve

Under the D'Arcy Concession, D'Arcy was required to cause any company or companies which he formed to exploit the concession to pay 16 per cent to its or their net profits to Iran. Parts of two Articles of the D'Arcy Concession are worthy of note:

> Article 9: The Imperial Persian Government authorizes the Concessionnaire to found one or several companies for the working of the Concession.
>
> Article 10: It (the Concessionnaire) shall also pay the said Government annually a sum equal to 16 per cent of the annual net profits of any company or companies formed in accordance with the said Article.
>
> The parties clearly contemplated the existence of more than one company.

Article 10 suggests this and the very nature of the oil business requires multiple companies.[24] Judging from the reaction of the Iranian government to Anglo-Persian's attempts to minimize profits by forming subsidiary companies to operate outside of Iran, Iran obviously thought it was entitled to 16 per cent of their net profits. Article 10, however, refers to the company or companies formed for the "working of the Concession." It is so obvious as to scarcely bear mention that D'Arcy did not need Iran's permission to operate outside of Iran and that the concession which was in Iran could only be worked from within Iran.

The Resolution of the Problem

Article 1 of the Armitage-Smith Agreement made clear that subsidiary companies, with the single exception of companies engaged in transporting oil by means of ships, were to pay 16 per cent of their net profits to the government. Yet the agreement did not end all of the financial inequities existing between the parties. First, Article 1 of the Armitage-Smith Agreement excluded profits "from the transporting of oil by means of ships." This exclusion effectively eliminated a great deal of profit that Iran thought it was entitled to under the terms of the D'Arcy Concession. What is striking about not allowing Iran to receive a payment form this particular subsidiary company is that under Article 2 of the Armitage-Smith Agreement, freight costs were to be deducted from gross revenue in arriving at the net profits figure. Accordingly, Iran was to subsidize the activities of the shipping company yet derive no revenues from the shipping company. Furthermore, Anglo-Persian, under Article 2 of the Agreement, was authorized to base freight rates for their own ships "upon the ordinary market time charter rates for tankers similar to those employed in carrying the oil, irrespective of the freight rates actually paid." Iran, in effect, was to contribute to the profits of the shipping company.

A second financial inequity faced by Iran was the fact that if these subsidiaries were operating outside of Iran, they were entitled to make certain deductions from net profits based upon the volume of petroleum products handled. In other words, certain subsidiary companies would pay less of a royalty to Iran as the volume of Iranian oil handled by these subsidiary companies increased. The deductions anticipated were such that Article 3(c) of the Agreement states: "if such deductions more than absorb the whole of the profit, then any deficiency so caused shall not be carried forward to any subsequent year." Accordingly, it was possible for the subsidiaries to make profits but pay the government nothing.

Third, Article 7 (iii) of the Agreement allowed Anglo-Persian to deduct from gross revenues any taxes paid to the Iranian government. The effect of this provision was to require the Iranian government to finance with Iranian money taxes owed to the Iranian government. This is shown by the following example. If gross revenue of $100 were obtained and government taxes were $20/ $100 of gross revenue, then the company's gross revenue, for tax purposes, would be but $80. The payment of 16 per cent of this figure would net the government $12.80. On the other hand, if taxes were not allowed to be deducted, the Iranian government would have received $20 plus $16 or a total of $36 instead of $32.80. On an income such as the company enjoyed, a loss of $3.20 per $100 to the Iranian government would have been of great significance.

A final inequity between the parties was that a subsidiary company was defined as a company in which Anglo-Persian controlled "more than fifty per cent of the total votes which can be cast at a general meeting." The opportunities afforded the company to circumvent the effect of Article 1 by forming subsidiaries in which it had less than fifty per cent ownership interest are evident. It is to be noted that much less than fifty per cent interest is sufficient for defacto control of a company.

Other Significant Terms of the Armitage-Smith Agreement

The Iranian government was relieved of the onus of protecting the company's property and was required instead by Article 10 of the agreement to use its "best endeavours to facilitate the work of the "Company!"

The company agreed to pay to the Iranian government the sum of one million pounds sterling in settlement of all claims of the Iranian government including royalties up to March 31, 1919.

The Armitage-Smith Agreement indicates that Iran was no longer wholly dependent upon Anglo-Persian. This is indicated by the fact that the company accepted, to a large degree, the Iranian definition of net profits of subsidiary companies. The second stage in the relationship between a state and an investor-developer has been reached. The investor-developer, Anglo-Persian, had developed a very profitable concession. To safeguard the concession, the company was willing to allow Iran to share in the profits of the subsidiary companies—a right which Iran had long demanded.

Problems Arising After the Armitage-Smith Agreement

The Armitage-Smith Agreement clearly improved the contractual relationship between the parties. Yet this agreement did not eliminate the conflict between the company and Iran. In 1925 a nationalist revolution swept Iran and Reza Khan was named Shah by the Parliament. One result of the revolution was that a new concession agreement was called for and between 1925 and 1931 negotiations were conducted between the parties with the object being agreement on a new concession. The company ceased negotiating in 1931 "since the demands of the Persian government were greatly in excess of anything which the Company could accept."[25] The principal demand which Iran made upon the company was for an annual guarantee of 2.7 million pounds sterling.[26] Negotiations began again when the Iranian government chose to return to the bargaining table in 1933. After arguments over what could be deducted from gross revenue under Article 10 of the D'Arcy Concession agreement were resolved, a new agreement between the Iranian government and the company was initialed. This agreement was to replace the D'Arcy Concession and the Armitage-Smith modifications of the D'Arcy Concession. The agreement was submitted to the Iranian Parliament on May 29, 1932, but was never ratified. The annual report of the company had been released on June 3, 1932 and the Iranian government was to receive a royalty of only 306,872 pounds sterling in 1931 as compared with a royalty of 1,288,312 pounds in 1930. This poor performance was directly traceable to the depression yet it caused a crisis between Iran and the company.

On November 27, 1932, approximately six months after the release of the annual accounting, the D'Arcy Concession was cancelled. The Iranian announcement of the cancellation was communicated in a letter to the resident director of the company by the Iranian Minister of Finance. The letter, in part, read as follows:

> The defects and shortcomings of the D'Arcy Concession and its disagreements with Persian interests have been repeatedly pointed out, and of course the Persian Government cannot legally and logically consider itself bound to the provisions of a concession which was granted prior to the establishment of a constitut-

> ional regine in view of the manner in which the concession was obtained and granted at that time.[27]

What is particularly interesting about the cancellation is that the Iranian government allowed itself a means by which it would escape the full wrath of the British government, the principal shareholder in Anglo-Persian,[28] for the Iranian Minister of Finance stated in the same letter that the "Persian Government will not in principle refuse to grant a new concession to that company."[29]

The British reponse to the Iranian cancellation of the concession came quickly. On December 2, 1932, the British Ambassador to Teheran issued a strongly worded statement which in part reads as follows:

> His Majesty's Government consider the action of the Persian Government in cancelling the Company's concession to be an inadmissible breach of its terms; they take a most serious view of the conduct of the Persian Government. His Majesty's Government will not hesitate, if the necessity arises, to take all legitimate measures to protect their just and indisputable rights.[30]

Britain's ability to employ force is probably the most obvious reason why the Iranian government chose to conclude another concession agreement. However, economic reasons existed as well. In 1932 the Iranians could not possibly have operated the oil fields by themselves. Further, Anglo-Persian had been granted concessions by Iraq and Kuwait. Therefore, there was no question of the British bowing to Iranian demands because a loss of supplies was feared. The Iranians found themselves in a unenviable position of being unable to act decisively because their revenues (and thus the continued existence of their government) would be threatened.

The 1933 Concession

The disagreements that occurred after the Armitage-Smith Agreement were settled by compromise. However, once again, the compromises were ostensibly made by Anglo-Persian but were in actuality made by the Iranian government. The financial terms of the 1933 Concession substantiate this hypothesis.

The text of the 1933 Concession is found in Schedule B.[31]

The Financial Terms of the New Concession

Article 10 of the 1933 Concession modified the financial basis of the concession considerably. First, the percentage basis upon which the royalty payment was previously calculated was completely discarded and a payment of four shillings gold per ton of petroleum produced was substituted. It is submitted that this shift in calculating the payments was directly related to the economic situation existing in the 1930's. On the one hand, a guaranteed payment per ton of petroleum produced is advantageous in times of economic crisis because at least some revenue will be produced. On the other hand, in times of economic growth, a set payment per ton of petroleum produced is often unrealistic in relationship to company profits.

The company was also required by Article 10 of the 1933 Concession to pay a sum equal to 20 per cent of any dividends paid by the company to shareholders in excess of 671,250 pounds sterling. In principle, this provision would benefit the Iranian government in times of high company profits and thus equalize any difficulties caused by the set payment of four shillings per ton of petroleum produced. However, this provision without more would have been useless because the company alone could determine what dividends it paid.[32] If the company were to choose to pay nothing in a given year, Iran would receive nothing. Article 10 (1)(b) of the Agreement, however, entitled Iran to the payment even if all of the income was added to company reserves:

> Payment of a sum equal to twenty per cent (20%) of the distribution to the ordinary shareholders ... in excess of the sum of six hundred and seventy-one thousand two hundred and fifty pounds sterling (671,250), whether this distribution be made as dividends for any one year or whether it relates to the reserves of the Company, exceeding the reserves which according to its books existed on 31st. December 1932.

Article 10 (1)(c) also significantly modified the previous terms of the D'Arcy Concession. Under this provision the Iranian government was guaranteed that the annual payment and the distribution described above of twenty per cent would amount to not less that 750,000 pounds sterling. When one recalls that the distribution to the government from Anglo-Persian was to be only 306,872 pounds sterling in 1931 under the D'Arcy Agreement, this provision seems significant. However, it is useful to compare the guaranteed £ 750,000 amount with the company's performance after 1933.

The Financial Performance of Anglo-Persian

In 1934, one year after agreement on a new concession, the company's net profit after tax was 3,183,000 pounds; British tax was 512,000 pounds; and the payment to Iran was 2,190,000 pounds sterling.[33] By 1950 the figures were net profit after tax, 33,103,000 pounds; British tax, 50,707,000 pounds, and the payment to Iran, 16,032,000 pounds.[34] The concept of a minimum payment of £750,000 was an improvement upon the provisions of the previous concession agreements—although the amount selected was proved to be unrealistically low.

Additional Financial Provisions of the 1933 Concession

Article 11 absolved the company from paying any tax, either state or local, in return for the payment during the first fifteen years of the concession of nine pence for each of the first six million tons of petroleum produced and six pence for each ton in excess of six million tons produced. This payment was made in addition to the royalty payment of four shillings per ton of petroleum extracted. During the last fifteen years of the concession, one shilling for each of the first six million tons of petroleum produced and nine pence for each ton thereafter was to be paid. Again, this payment was made in addition to the royalty of four shillings per ton of petroleum extracted.

There was a guarantee of at least 250,000 pounds sterling in lieu of taxes for the first fifteen years of the agreement and of at least 300,000 pounds sterling annually during the last fifteen years of the agreement. These sums plus the minimum payment guaranteed by Article 10 assured Iran of an income of at least 975,000 pounds sterling per year. It is noted that this amount is considerably less that the minimum income of 2,700,000 pounds sterling per year which the Iranian government had demanded in 1931.

As a final conciliatory move, Anglo-Persian, by Article 23, agreed to pay to the Iranian government a sum of one million pounds sterling and in addition to compute payments for the year 1931 and 1932 on the basis of the 1933 Concession and not under the terms of the Armitage-Smith Agreement which was in effect during this two year period. The Company also agreed to pay a sum calculated in accordance with Article 11 in lieu of taxes payable to the Iranian government in 1931 and 1932.

Termination of the Concession

The 1933 Concession provided for the circumstances under which the concession could be terminated. No equivalent provision existed under the D'Arcy Concession. However, under the 1933 Concession, it was provided that the "Concession can only come to an end in the case that an Arbitration Court should declare the Concession annulled as a consequence of default of the Company in the performance of the present Agreement."[36] Default was defined as the liquidation of the company or the failure by the company to pay an arbitration award. It should be noted that the likelihood of an incredibly profitable company's liquidating its assets or failing to pay an arbitration award is extremely small.

The Relinquishment Provision

The above discussion clearly shows that the Iranian derived some financial benefits under the terms of the 1933 Concession. However, this benefit must be assessed in the context of the economic downturn that existed in the 1930's. Under these economic conditions, a fixed payment per ton of petroleum extracted would surely provide more revenue for Iran. While the increased revenues were of significance to the Iranian government, the most important aspect of the 1933 Concession is that a provision was accepted by the company which called for the relinquishment of parts of the concession.

Under Article 2 of the 1933 Concession the company was bound by December 31, 1938 to select an area of 100,000 square miles. This contrasts considerably with the 500,000 square mile area comprising the original D'Arcy Concession. The introduction of the relinquishment concept into the Middle East in 1933 was quite extraordinary when one considers that the other concessions (the Aramco-Saudi Concession of 1939, for example) were renegotiated but the areas of the concessions were increased.[37]

The ostensible reason for reducing the area of the concession was to further the development of Iranian petroleum by allowing other companies to enter and compete. In addition, Anglo-Persian's loss of the exclusive right to construct and own pipelines by Article 3 of the 1933 Concession, facilitated the possibility of non-British entry into the Iranian oil fields. However, the few firms who attempted to gain a concession at this time were unsuccessful owing to British opposition.[38]

The 1933 Concession: A Summary

It is submitted that the 1933 Concession was an example of the progressive evolution of oil concession agreements. While the change to a set royalty per ton of petroleum produced was not particularly innovative, the relinquishment provisions of the concession were. These two provisions together increased the power of Iran, at lease conceptually, because the area of the concession was reduced and Anglo-Persian was not allowed to hold a monopoly over pipeline construction and utilization. These provisions set the stage for the later entry of competitors.[39]

The Concession From 1933 to 1951

The 1933 Concession succeeded remarkably well until the 1951 nationalization of the oil industry by Iran. However, while serious difficulties were not present between the parties, differences did exist because the company's profits continued to increase dramatically.[40] In addition, the chief beneficiary of any increase in profits was the British government owing to its taxation power over the company and its majority ownership of shares in the company. That Britain was gaining the most benefit from Iranian oil increased the discontent of the Iranian people. The ultimate ramification of this discontent was the nationalization of the company in 1951. Prior to the nationalization, as difficulties between the parties increased, the Parliament of Iran passed a law which intimated that changes in the concession would have to be made.

The Single Article Law of October 22, 1947

Section (e) of the Single Article Law stated the following:

> In all cases where the rights of the Iranian nation, in respect of the country's natural resources, whether underground or otherwise have been impaired, particularly in regard to the southern oil, the Government is required to enter into such negotiations and take such measures as are necessary to regain the national rights and inform the Majlis of the results.[41]

The Supplemental Agreement

On July 17, 1949 a modification of the 1933 Concession (known as the "Supplemental Agreement") was initialled but was ultimately rejected by the Iranian Parliament. The text of the Supplemental Agreement is found in Schedule C.[42]

The Supplemental Agreement indicates that the company realized that its position in Iran was no longer set upon a firm footing and that Anglo-Iranian no longer wielded the balance of power.[43]

Financial Terms of the Supplemental Agreement

The financial provisions of the Supplemental Agreement were intended to modify the provisions of the 1933 Concession significantly. Article 3 (a) of the Supplemental Agreement was to increase the payment per ton of petroleum from four shillings to six shillings, an increase of fifty per cent. The provision was to be given retrospective application to 1948 which meant that a sum of $3,364,459 pounds sterling would have been due the Iranian government.

Article 4 of the Supplemental Agreement would have modified the 1933 Concession in respect of the payment of twenty per cent of dividends or increases in general reserves (Article 10 (1)(b) in a manner that would have guaranteed the Iranian government a minimum payment of 4,000,000 pounds sterling annually.

Article 4's guarantee was to continue during the term of the agreement. Article 5 of the Supplemental Agreement would have provided an immediate payment of 5,090,909 pounds sterling as fulfillment of the conditions contained in Article 4.

Under Article 7 (a) of the Supplemental Agreement, Article 11 of the 1933 Concession was to be modified and one shilling for every ton of petroleum in excess of six million tons produced was to be paid instead of nine pence. This represented an additional sum of 312,000 pounds sterling that would have been due the Iranian government.

Both the intent and scope of the Supplemental Agreement indicate that Anglo-Iranian was willing to pay well to assure the continued existence of the concession. However, as stated above, the Supplemental Agreement was not supported by Parliament because the agreement "did not satisfactorily safeguard Iranian rights and interests."[44] On February 15, 1951, a motion was introduced in Parliament by Dr. Musaddiq, Chairman of the Oil Committee of Parliament, which called for the nationalization of the company. On April 28, 1951, the motion was approved by Parliament. The Shah assented on May 1, 1951. Anglo-Iranian was thus nationalized.

Footnotes Chapter 2

1. A. Z. Yamani, "The Oil Industry in Transition" (1975) 8 Natural Resources Lawyer 391. The term "international oil companies" is used because the holders of the principal concessions in the Middle East were the seven major international oil companies. The independent oil company did not become a factor in Middle East oil until the 1960's.

2. Z. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions: 1901 - 1965 (1966) 10

3. Article 4 of the D'Arcy Concession

4. The text of the D'Arcy Concession can be found in I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdon v. Iran) 224 and on pp. 7-11 of this thesis.

5. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions: 1901 - 1965 supra n. 2 at 12

6. The British government later became involved with the D'Arcy Concession as the major shareholder of the Anglo-Persian Oil Co. Ltd. Because of the importance of petroleum to the British Admiralty, Anglo-Persian became, in effect, an arm of the British government. The gact that Britain exercised a sphere of influence in Iran and other countries of the Middle East accounted for this heavy British involvement in the affairs of the company.

7. The first company D'Arcy formed was named the "First Exploitation Company," a company incorporated under the laws of England, which was registered on May 21, 1903.

8. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions: 1901 - 1965, supra n. 2 at 12

9. id. at 13

10. An example of this inability on the part of the Iranian government to exercise effective control over the country concerned the company's attempts to construct a pipeline in southern Khuzistan, which borders on the Persian Gulf and Iraq. Control of this area was exercised by a local Sheikh named Kazal who was independent of the centeral government in Teheran. The British government (and not Anglo-Persian) negotiated with Khazal and an agreement was signed on July 16, 1909, which allowed a pipeline to corss the Sheikh's terrotory, gave the company one square mile of Abadan Island for a refinery and guaranteed the integrity of the company's property. See G. Stocking, Middle East Oil (1970) 13.

11. G. Stocking, Middle East Oil (1970) 13

12. id. at 13

13. Mikdashi, A Financial Analysis of Middle Eastern Oil Concession: 1901 - 1965, supra n. 2 at 15

14. When Winston Churchill became Lord of the Admiralty shortly before the First World War, he ordered that the British fleet use oil instead of coal, because of the greater efficiency of coal.

15. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions: 1901 - 1965, supra n. 2 at 15

16. id. at 38

17. I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdon v. Iran), supra n. 4 at 321

18. id. at 673

19. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions, supra n. 2 at 32

20. id. at 32

21. Refineries were established by Anglo-Persian in Iraq and Aden.

22. I.C.J. Pleadings,Anglo-Iranian Oil Co. Case (United Kingdon v Iran) supra n. 4 at 241

23. The text of the Armitage-Smith Agreement can be found in I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdon v. Iran) 229 and on pp of this thesis.

24. Oil activities can be divided into at least three phases: producing, processing and marketing. Because each phase is independent, certain tax advantage exist by forming different companies to be responsible for each phase.

25. I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdon v Iran), supra n. 4 at 190

26. Stocking, Middle East Oil, supra n. 11 at 27

27. I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdon v. Iran), supra n. 4 at 235

28. Since the British government was the principal shareholder in the company and since the fleet was dependent on Iranian oil, the British were in a position to react harshly to the nationalization. The Suez crisis of 1956 reflected the lengths to which Britain would go when threatened by Middle Eastern states.

29. I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdon v. Iran) supra n. 4 at 236

30. id. at 237

31. The text of the 1933 Concession can be found in I.C.J. Pleadings Anglo-Iranian Oil Co. Case (United Kingdon v. Iran) 258 and on pp of this thesis

32. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions 1901 - 1965, supra n. 2 at 78

33. id. at 109

34. id. at 110

35. League of Nations, Official Journal, XIV (1933) 202

36. Article 26 of the 1933 Concession

37. The concession granted to ARAMCO in 1933 covered an area of 371, 000 square miles and upon renegotiation in 1939 was extended to 496, 000 square miles. (See "From Concession to Participation: Restructuring The Middle East Oil Industry" (1973) 48 New York Unviersity L. Rev. 776)

38. American companies were unable to enter Iran at this time because Iran was in the British sphere of influence. See F. Halliday, Arabia Without Sultans (1974) 470

39. Other international companies did not enter Iran to take advantage of these provisions. The independent companies that were in existence at this time confined their activities to North America. The major oil companies controlled the marketing and production of petroleum world-wide and there was no one yet willing and able to compete with Anglo-Persian on its own territory.

40. Stocking, Middle East Oil, supra n. 11 at 154

41. I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdom v. Iran), supra n. 4 at 273

42. The text of the Supplemental Agreement can be found in I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdom v. Iran) 274 and on pp of this thesis.

43. Anglo-Persian became the Anglo-Iranian Oil Co. Ltd. on June 28, 1935

44. I.C.J. Pleadings, Anglo-Iranian Oil Co. Case (United Kingdom v. Iran) supra n. 4 at 216

Chapter 3

The Iranian Concession: 1951-1973

The British government reacted angrily to the nationalization of Anglo-Iranian. Sharp notes were exchanged between the British government and the Iranian Foreign Ministry.[1] In fact, the British went so far as to bolster their fleet in the Mediterranean, where the British military presence was already unassailable. The Suez Canal was the site of a major British military base; Jordan and Iraq were within the British sphere of influence; and the Emirates were British protectorates. The British were thus in a position to use military force to achieve their objectives in Iran.

The Role of the International Court of Justice

The British chose instead to refer the dispute to the International Court of Justice. On May 26, 1951, approximately three weeks after the nationalization, the government of Britain formally asked for an interim injunction. On July 5, 1951, the International Court of Justice rendered a decision which reads, in part, as follows:

> The Imperial Government of Iran should permit the Anglo-Iranian Oil Company, Limited, its servants and agents, to search for and extract petroleum ... , and generally, to continue to carry on the operations interference calculated to impede or endanger the operation of the Company, by the Imperial Government of Iran, their servants or agents, or any Board, Commission, Committee, or other body nominated by them.[2]

The Iranian government reacted to the International Court's decision of July 5, 1951, as asserting that the Court was without jurisdiction to hear the dispute as a private company was involved, and not the British government. After pleadings, oral arguments, and documents had been submitted to the Court, a decision was reached on July 22, 1952, in which the Court held that it had no jurisdiction over the matter. The decision, in part, is as follows:

> The Court cannot accept the view that the contract signed between the Iranian Government and the Anglo-Persian Oil Company has a double character. It is nothing more than a concessionary contract between a government and a foreign corporation. The United Kingdom Government is not a party to the contract; there is no privity of contract between the Government of Iran and the Government of the United Kingdom. Under the contract the Iranian Government cannot claim from the United Kingdom Government any rights which it may claim from the Company, nor can it be called upon to perform towards the United Kingdom Government any obligations which it is bound to perform towards the Company. The document bearing the signatures of the representatives of the Iranian Government and the Company has a single purpose: the purpose of regulating the relations between that Government and the Company in regard to the concession. It does not regulate in any way the relations between the two Governments.
>
> This juridicial situation is not altered by the fact that the concessionary contract was negotiated and entered into through the good offices of the Council of the League of Nations, acting through its Rapporteur. The United Kingdom, in submitting its dispute with the Iranian Government to the League Council, was only excersing its right of diplomatic protection in favour of one of its nationals. It was seeking redress for what it believed to be a wrong which Iran had committed against a juristic person of British nationality. The final report by the Rapporteur to the Council on the successful conclusion of a new concessionary contract between the Iranian Government and the Company gave satisfaction to the United Kingdom Government. The efforts of the United Kingdom Government to give diplomatic protection to a British national had thus borne fruit, and the matter came to an end with its removal from the agenda.
>
> Throughout the proceedings before the Council, Iran did not make any engagements to the United Kingdom other than to negotiate with the Company, and that engagement was fully executed. Iran did not give any promise or make any pledge of any kind to the

> United Kingdom in regard to the new concession. The fact that the concessionary contract was reported to the Council and placed in its record does not convert its terms into the terms of a treaty by which the Iranian Government is bound *vis-a-vis* the United Kingdom Government.[3]

The British Boycott of Iranian Oil

After the decision of the International Court of Justice, the British pursued an alternate political strategy. The British instituted a boycott of Iranian crude oil and from July 1951 to August 1953 only 120,000 tons of oil worth $1.86 million U.S. were exported from Iran.[4] By comparison, oil exports from Iran in 1950 had been 31.75 million tons worth $400 million U.S.[5]

The British boycott was effective for several reasons. First, no energy crisis existed in the West at that time; there was such an abundance of oil that the British found no reason to purchase the nationalized oil during the period of dispute. Shortages from Iran had been compensated for by increased production from other Middle Eastern states, namely Iraq and Kuwait, where Anglo-Iranian also held concessions. Refineries were built in Europe, Aden and other countries of the Middle East to replace the capacity of the Abadan refinery which had been lost to Anglo-Iranian as a result of the nationalization.

A second reason for the success of the British boycott was the fact that court proceedings were brought by the company to halt the sale of Iranian crude oil from the concession area. The case of Anglo-Iranian Oil Co. Ltd. v. Jaffrate and Others (The Rose Mary), (1953) 1 W.L.R. 246 is one example. In that case an Italian oil company had contracted with the National Iranian Oil Company to purchase a quantity of crude oil from the concession area. When the ship transporting the crude oil berthed in Aden, Anglo-Iranian instituted an action in detinue claiming the crude oil carried by the ship.

The Aden court held that the oil was the rightful property of Anglo-Iranian for several reasons. The Court held that the 1951 nationalization decree was invalid by international law for the company's property in Iran was expropriated without compensation. The Court further held that international law is incorporated into English domestic law except where such law would be inconsistent, and it was in a position to apply that law. The Court further stated that an enquiry of this nature would not normally be held if the property confiscated was the property of a citizen of the expropriating state However, owing to the facts that the property confiscated was that of a British company and that compensation had not been paid, the Court ordered that title to the oil be given to Anglo-Iranian. Similar decisions were reached in other courts in other jurisdictions.[6] The cumulative effect of the decisions prevented many potential purchasers from entering into negotiations with the Iranian state company for the purchase of oil.

The Consortium Agreement

This state of affairs continued until August 9, 1953, when a coup led by General Zahedi, and directed by the Centeral Intelligence Agency, toppled Dr. Musaddiq's government.[7] The Shah, who had fled the country earlier, returned and began the task of restoring Iranian oil production and coming to terms with Anglo-Iranian. The "coming to terms" resulted in what became known as the Consortium Agreement,[8] between Iran and oil companies from Britain, Holland, France, and the United States.

The Relationship Between The Parties

Under the Consortium Agreement, Anglo-Iranian's interest in the concession was to be reduced to forty per cent. Shell was to receive a 14 per cent interest; Jersey, Socal, Texas, Gulf and Socony were to receive a 7 percent interest each; Compagnie Francaise Des Petroles, a 6 percent interest; and Iricon Agency, a 5 per cent interest.[9] In addition, Richfield, San Jacinto, Sohio, and Atlantic Refining were to receive a 0.417 per cent interest each carved out of the interests given to the other American oil companies referred to above.[10]

Pursuant to the Agreement, two companies were organized by the Consortium members to operate the concession--the Iranian Oil Exploration and Producing Company and the Iranian Oil Refining Company. These two companies were called the Operating Companies. The Operating Companies were organized under the laws of the Netherlands and registered in Iran. Two of the seven directors of each company were Iranian citizens. The Operating Companies were authorized by Article 4 of the agreement to search for and produce petroleum products.

The National Iranian Oil Company, which had been formed by the Iranian government after the nationalization, became the owner of the physical properties used in producing and refining the petroleum.[11]

A third type of company was provided for in the agreement and this was called a Trading Company. Each member of the Consortium was authorized but not required by Article 18 to form a Trading Company. The Trading Company was to act as a buyer of oil and natural gas from the NIOC.

The Term of the Consortium Agreement

By Article 49 of the agreement, the concession was to continue for a period of twenty-five years. Article 49 also contained a provision allowing for two extensions of the term of the agreement, each of five years.

Financial Arrangements Between The Parties

The financial arrangements relating to the Trading Companies are contained in Article 22 of the Agreement. Each Trading Company was to pay a set fee of 12.5 per cent of the posted price of crude oil to Iranian government.

The Posted Price

A crucial factor to consider when analyzing this royalty provision is that the posted price of crude oil was determined, in 1954, not by the Iranian government but rather by the Trading Company involved. Article 1 (N) defines posted price as

> the price at which crude oil of equivalent quality and gravity is offered for sale by a Trading Company or its affiliated company to buyers generally for delivery under similar conditions and at the same seaboard terminal.

Accordingly, the value of this royalty of 12.5 per cent of the posted price was determined by the international oil companies. Since the principal markets for crude oil were controlled by the international companies involved in the Consortium Agreement, the price was kept at a level which precluded competition from independent oil companies. This procedure effectively prevented Iran from deriving some of the benefits a competitive marketplace would have offered.

Article 25 of the Agreement did limit somewhat the power of the companies to set the posted price of crude oil. Article 25 required that total gross receipts for each Trading Company be not less than a sum equal to (a) the value of the applicable posted price, plus (b) the refining fee, plus (c) a sum which when added to the refining fee equalled five per cent of the posted price. However, this base was eroded in part by section D of Article 25 which allowed discounts from the posted price. By Article 25 (B)(3) the value of these discounts could be subtracted from gross receipts as determined under Article 25.

Additional Financial Arrangements

In addition to the 12.5 per cent royalty to be paid to the Iranian government, the Trading Companies were required by Article 28 to pay income tax on profits earned from the sale of crude oil and petroleum products. The ultimate tax to be paid equalled approximately 50 per cent of the net profits of the Trading Companies. These profits equalled the difference between the value of the oil sold (determined as stated above by the posted price) and the expenses and charges of the Operating Companies.[12] The 12.5 per cent royalty was not expensed but instead was credited agains tax payable in order to reach an effective rate of fifty percent of the net income.[13]

The effect of this fifty per cent tax rate was diminished somewhat by Article 28 (B)(3) (C)(1) which allowed certain deductions from gross income. An amount equal to 2.3% of 87.5% of the value of all crude oil produced, of the value of all crude oil refined, and of the value of all crude oil delivered to the NIOC in lieu of the 12.5 per cent royalty was allowed to be deducted from gross income by this Article.

Financial Arrangements Relating to the Operating Companies

Article 13 of the Consortium Agreement provided that a fee of one shilling per cubic meter of crude oil and one shilling per cubic meter of crude oil refined be paid to the Operating Companies.[14] This fee was to be paid by the Trading Companies for their share of the oil produced and refined and by the NIOC for its share of the oil produced and refined.

The Operating Companies, under Article 6 (D), were allowed a fixed assets charge of 6.7 million pounds sterling per year during the first ten years of operation under the agreement.[15] This provision is somewhat unique as the NIOC by the terms of the agreement was the owner of the physical properties used in producing and refining the petroleum. This 6.7 million pounds sterling is of significance because it would reduce the income of the Operating Companies that was subject to Iranian income tax laws.

The Consortium Agreement contained another provision relating to the financial relationship between Iran and the Operating Companies. Article 7 dealt with the acquisition of lands needed by the Operating Companies. Since the NIOC by the terms of the Agreement was to be the owner of all physical properties used in exploration and production, the NIOC would acquire the property. The manner in which the NIOC acquired the property is interesting for the Operating Companies were requred to purchase the property in the name of the NIOC. In return, the Operating Companies were allowed a land assets charge over a twenty year period or the duration of the agreement, whichever was shorter. In this manner, the NIOC acquired ownership without the necessity of directly paying for the property involved.

Additional Significant Terms of the Consortium Agreement

(a) Required Exploration Expenditures

The Consortium Agreement laid the ground work in Article 49 for the requirement that a certain amount of money be expended by the companies in exploration activities. As a condition of renewal of the Consortium Agreement, the Exploration and Producing Companies were required to spend on exploration projects "an amount not less than the aggregate of fees earned by it during such five year period." The five year period referred to above would be that period after a renewal notice was to be given to the Iranian government by Consortium members.

(b) Required Production Quantities

A further significant term contained in the Consortium Agreement was the guarantee provided by the Consortium members that a stated quantity of crude oil would be produced. In 1955, 17,500,000 cubic meters were to be produced; in 1956, 27,500,000 cubic meters; and in 1957, 5,000,000 cubic meters.[15] The purpose of the Iranians in including a guarantee of a specific quantity in the Agreement was to assure that the international oil companies would develop a market for their crude oil. Once a market had been established and in many cases reestablished, owing to the hiatus during the nationalization crisis, Iranian production could increase and with it governmental revenues.

(c) Payment in Kind

The Consortium Agreement contained a provision allowing the NIOC to take their royalty of 12.5 per cent in oil[17] This provision was very significant for it signaled to the international oil companies that the NIOC would one day directly compete with them.

(d) Resolution of Disputes

Much consideration was given in the Consortium Agreement to the means by which disputes were to be resolved. All parties were virtually concerned that the venture proceed without difficulty and that the mistakes that resulted in the nationalization not be repeated. The text of Article 41 of the Consortium Agreement took this concern into account:

> No general or special legislative or administrative measures or any other act whatsoever of or emanating from Iran or any governmental authority in Iran (whether central or local) shall annul this Agreement, amend or modify its provisions or prevent or hinder the due and effective performance of its terms.

A Comparison Between the 1933 Concession and the Consortium Agreement

(a) Fiscal Differences

The most important fiscal factor that differentiated the 1933 Concession agreement from the 1954 Consortium Agreement was that the 1954 agreement abandoned the concept of a set royalty per ton of crude oil exported. While the 50-50 sharing of profits concept was not introduced into the Middle East by Iran, this concept represented a major development in the evolution of the relationship between the international oil companies and Iran.[13] There was no longer any question that investment in Iranian petroleum development would be profitable. The risk factor had changed and this sharing of profits emphasized this change.

A second difference between the 1933 Concession and the Consortium Agreement was that the latter eliminated any variation in the amount paid for crude oil on the basis of the quantity of crude oil exported. Under Article 11 (1)(a) of the 1933 Concession Agreement, Anglo-Iranian was required to pay in addition to the royalty of four shillings per ton of petroleum a sum of nine pence for each of the first six million tons exported and six pence for each ton in excess of six million tons exported.

The Consortium Agreement, instead, relied upon a posted price which was calculated as the price prevailing from time to time for crude oil in the Arabian Gulf.[19]

A third difference between the two agreements was concerned with the profits of subsidiary companies. The 1933 Concession agreement resulted in part because of the controversy surrounding the refusal of Anglo-Persian to account for the profits of subsidiaries.[20] The 1933 Concession agreement resolved this difficulty by making the profits of all subsidiary companies except those in the business of shipping oil subject to a royalty of 16 per cent of net profits. The Consortium Agreement eliminated any possibility of misunderstanding by specifying exactly which profits of the consortium members were taxable. Under Article 28 of the Agreement, the only income upon which tax was payable was income earned by the Trading Companies and the Operating Companies in Iran. The relevant section of Article 28 is as follows:

> If the income and receipts actually realized...are in accordance with the provisions of this Agreement, the Trading Companies and the Operating Companies shall not for Iranian income tax purposes be deemed to have any further income or receipts from their sales, operations and functions under this Agreement.

The income earned was to be the difference between the posted price of the crude oil and the cost of producing the petroleum. As one might expect, the difficulties that grew between the parties concerned the posted price of the crude oil because production expenses during the course of the Consortium Agreement remained static. The readjustment upwards of the posted price was a logical means by which Iranian revenues could increase.[21]

Conclusions

In summary, the Consortium Agreement marked a major change in the relationship between Iran and the companies operating in Iran. The most significant change in the relationship was the acceptance by Anglo-Iranian if its lesser role and the acceptance by the Consortium members of the 50-50 profit sharing formula. The Consortium Agreement represented the high point of the second stage in the relationship between Iran and the oil companies operating in Iran. Both parties derived substantial revenues from the exploitation of the concession. Iran still required the presence of the companies for their technical and marketing expertise. The companies wished to remain because of the substantial profits they derived from their association with Iran.

The Consortium Agreement: 1954-1973

Difficulties existed between the parties to the Consortium Agreement but these disagreements were not unique to Iran and the Consortium members. From 1954 until 1973, when a new agreement was reached between the parties, the major disagreements were centered on two issues: the expensing of royalites and the rate of production of crude oil.

The Expensing of Royalties

The issue of whether the royalties should be expensed or credited against the tax rate created much difficulty between the parties. Under the terms of the Consortium Agreement, the royalty of 12.5 per cent of net profits which in effect resulted in a tax rate of 37.5 per cent. if royalties were to be expensed, the Consortium members would pay the royalty of 12.5 per cent, deduct the royalty as an expense from their gross profits and pay a fifty per cent tax on the remainder.[22]

ERRATUM

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An agreement to resolve this issue was reached in 1954. Royalties were to be expensed, and in return, the companies were granted discounts from the posted price of crude oil of 8.5 per cent the first year; 7.5 per cent the second year; and 6.5 per cent the third year.[23] The posted price of crude oil was, however, to become an issue.[24]

The Level of Production of Crude Oil

The second major difficulty between Iran and the Consortium concerned Iran's repeated demands that oil production be increased. Two explanations exist as to Iran's desire for increased production. First, the level of production of crude oil had not reached pre-nationalization levels and governmental revenues suffered as a result. Second, Iran had initiated a rapid industrialization program and required additional revenues to continue this program.

The Consortium members yielded to Iranian demands in 1966 and several modifications were made in the agreement with the purpose being to increase the production of crude oil. The Consortium members agreed to release 25 per cent of the concession area immediately instead of the 20 per cent they were required to release in 1979. In addition, the Consortium members agreed to increase output by 13 per cent per year.

The Iranian Sales and Purchase Agreement

In July of 1973, the Consortium Agreement was replaced by the Iranian Sales and Purchase Agreement (hereafter ISPA).[25] This agreement was of great significance for the NIOC became the operator of the oil facilities in the former concession area.

Fiancial Provisions Under ISPA

Article 6 of the ISPA set out the formula by which the price of crude oil was to be determined. The price to be paid to the NIOC was equal to the sum of the operating costs, the stated payment, the balancing margin and the interest. Operating costs as well as the stated payment (i.e. the royalty of 12.5%) were to remain the same under ISPA. The innovations introduced by the ISPA concerned the balancing margin and the interest payment. The balancing margin was a calculation designed "to assure Iran that the total financial benefits and advantages to Iran and NIOC under this Agreement shall be no less favourable than those applicable (at present or in future) to other countries in the Persian Gulf."[26] This was in effect a most favoured nations price clause. The interest payment was a charge that the Trading Companies had to pay to the NIOC on investments, including working capital, required by the NIOC to produce the petroleum for sale to the Trading Companies. The agreement estimated that the interest charge was to be 0.418 cents per barrel.[27]

Other Significant Terms Contained In The ISPA

The NIOC, by Article 4 of the Agreement, took over the operation of the Abadan refinery and undertook to process up to 300,000 barrels of oil per day for the members of the Consortium. The Consortium members were not required to have this amount processed but were subject to a penalty equal to the cost of processing 95% of this figure of 300,000 barrels per day if they chose not to have their petroleum processed at Abadan. Furthermore, the processing fee charged by the NIOC was to be set-off against any remaining depreciation available on Consortium owned assets which were acquired by the NIOC under the agreement. This set-off of the processing fee against Consortium owned assets allowed the NIOC to acquire these assets without incurring direct costs to itself.

In order to facilitate the search for petroleum by the NIOC, the Trading Companies by Article 11 were required to advance to the NIOC as prepayment for crude oil purchases 40 per cent of the funds required for capital expenditures during the first five years of that agreement.

Income Tax Provisions Under The ISPA

The Trading Companies under the ISPA continued to be subject to Iranian income tax statutes as they were under the Consortium Agreement. Differences in the applications of the tax laws were evident though. First, the rate at which the income of the Trading Companies was to be taxed was readjusted from 50% to 55%.[28] Processing fees and the royalty of 12.5% were deductible from gross income. The interest payments referred to above were not allowed as a deduction from the gross income. The effect of not allowing the deduction of interest payments was to require the Consortium members to finance development expenditures undertaken by the NIOC.[29]

Levels of Crude Oil Production Under the ISPA

Under the terms of the agreement, the NIOC undertook to raise its production of crude oil to 8 million barrels per day. Of this figure, the NIOC was given the right in 1973 to 200,000 barrels per day; 300, 000 barrels per day in 1974; 450,000 barrels per day in 1975; and 1.5 million barrels per day in 1981.[30] After 1981 the crude available to the NIOC was to be in the same proportion as 1,500,000 barrels per day was to the total number of barrels produced per day in 1981.

Natural Gas Provision Contained in the ISPA

Another significant aspect of the ISPA related to the provisions dealing with natural gas.[31] Under Article 15 of the ISPA the NIOC possessed a preemptive right to natural gas for internal and export requirements. Remaining natural gas was available to Consortium members "for processing in plants established under projects acceptable to Iran for the export of gas or products."[32]

The important factor to remember when considering the new emphasis on natural gas was that the Consortium members would not accept delivery of the natural gas after it had been process by the NIOC. The effect of requiring the NIOC to process the natural gas was to develop an indigenous Iranian-owned natural gas industry.[33]

A Summary of the ISPA

In summary, the new agreement resulted in Iran's becoming the full "owner-operator" in the former Consortium Agreement area. The international companies comprising the signatories to the agreement became the offtakers of the crude oil remaining after Iran had satisfied both internal and export commitments.

The advantages to Iran under this agreement were numerous but the most important element of the agreement concerned the balancing margin referred to above. This provision allowed Iran a most favoured nations price on a barrel of oil sold in the Persian Gulf. The effect of the presence of the independent oil companies at this stage of developments was of great importance because these companies traditionally offered better terms to Middle Eastern states to assure a supply of crude oil. Therefore, once an independent company provided a better price for curde oil anywhere in the Persian Gulf, the Consortium members would have to follow its lead and pay more per barrel.

A second advantage that the agreement provided was that the NIOC replaced the Operating Companies which existed under the terms of the Consortium Agreement. By assuming the primary role in production and refining, the NIOC effectively acquired an eqivalence with the international oil companies. Furthermore, the political difficulties that often resulted when foreign oil companies were present in a state were minimized because the Consortium members now acted merely as buyers of the crude oil produced.

The ISPA also provided the Iranians with the opportunity of integrating the oil sector with their developmental plans. The provisions contained in the ISPA relating to the requirements of processing some oil and natural gas resulted in a large petrochemical industry in Iran. Furthermore, by the provisions of the ISPA, the level of production of crude oil now depended upon Iran's financial requirements and capabilities and not upon the marketing needs of the international oil companies.

It is perhaps useful in assessing the impact of the ISPA to refer to a statement made by Dr. Ali Amini, the Minister of Finance of Iran, about the Consortium Agreement of 1954 which he helped to draft:

> The solution I bring to you is perhaps not the ideal solution. But we do not have the means to compete in internzational markets because we do not possess a marketing organization. If anyone is capable of doing better, let him take our place.[34]

The ISPA was nearly the ideal solution to the difficulties presented by foreign participation in the Iranian petroleum industry. Iran did acquire the ability to market a great deal of her crude oil independently of the major oil companies. Furthermore, all decisions regarding exploration and production were made by the NIOC under the terms of the agreement.

The ideal solution mentioned by Dr. Amini was eventually reached in January of 1979 when the Shah was deposed and Iran assumed the role of marketing its total production of oil and natural gas. The signatories to the ISPA were then denied their allocation of crude oil to which they were entitled under the terms of the ISPA.[35] The difficulties posed by foreign participation in the Iranian oil industry were thus solved completely.

The third stage in the relationship between Iran and the investor-developer had been reached. Iran was able to act and cease dealing with the investor-developer for a number of reasons. First, the West was in the midst of an energy crisis and no surplus of crude oil existed. Second, the members of the Consortium were not in a position to secure alternative supplies of crude oil, and other companies were more than willing to purchase Iranian crude oil. Third, there was absolutely nothing the Consortium members could have done to force Iran back to the bargaining table. As a result of this situation, the Iranians were in a position to charge world prices for their petroleum without fear of reprisals from the West. Now, the position of Iran vis-a-vis the international oil companies was not unlike the position that William D'Arcy enjoyed when the D'Arcy Concession was signed in 1901.

Footnotes Chapter 3

1. See I.C.J. Pleadings, Anglo-Iranian Oil Co. Cas, (United Kingdom vs. Iran) 383-391

2. Anglo-Iranian Oil Co. Case, Order of July 5th, 1951: I.C.J. Reports 1951 90

3. Anglo-Iranian Oil Co. Case (jurisdiction), Judgment of July 22nd, 1952: I.C.J. Reports 1952 112

4. Z. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions: 1901 - 1965 (1966) 115

5. id. at 155

6. A similar lawsuit resulted in Italy over the cargo of the Miriella. Actions were also brought in Japan. See S. Longrigg, Oil In the Middle East (1968) 1970

7. See. D. Wise and T. Ross, The Invisible Government (1964) 110

8. The text of the Consortium Agreement can be found in Middle East Basic Oil Laws And Concession Contracts, Original Texts, vol. 1 (1959) Iran-C-1

9. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions: 1901 - 1965, supra n. 4 at 299

10. id. at 299

11. The NIOC at this time was incapable of conducting all oil programs by itself.

12. Mikdashi, A financial Analysis of Middle Eastern Oil Concessions: 1901 - 1965, supra n. 4 at 301

13. The Iranian Income Tax Act of 1949 (Article 35) reads as follows: In the case of companies whose net income (profit) is derived from the sale of petroleum or other hydracarbons ... , for the purposes of collection there shall be deducted from the amount of tax to be paid on their net income as provided by Article 7 an amount equal to any stated payment. The stated payment is defined in the Consortium Agreement as the royalty of 12.5%.

14. Article 13 A states the following:
The Operating Companies shall be entitled to the following fees: -
(1) Exploration and Producing Company - One shilling per cubic meter of crude oil delivered hereunder;
(2) Refining Company - One shilling per cubic meter of crude oil refined hereunder.

15. Article 6 (d) (1) states the following:

During the first ten years of operation hereunder, in each year a fixed assets charge referred to in Section A of this Article of £2,600,00 in the case of the Exploration and Producing Company, and £4,100,000, in the case of the Refining Company, shall be included in their respective operating costs. The proceeds of such fixed assets charges shall be disposed of as they see fit.

16. Article 20 of the Constortium Agreement

17. Article 23 A of the Consortium Agreement

18. The 50-50 sharing of profits concept was introduced into the Middle East by Saudi Arabis. Iran's 50-50 profit sharing arrangement was differentiated in one significant respect from the Saudi-Aramco Agreement. The Sauid profit sharing arrangement was calculated on net income after the payment of U.S. taxes by the oil companies involved. The Iranian profit sharing agreement made no such adjustments for U.S. taxes paid.

19. Note that discounts were given from the posted price of the crude oil. The size of the discounts offered were such that one could say that the intent of both the Consortium Agreement and the 1933 Concession was similar in that the price decreased as the volume purchased increased. Under the arrangement between Aramco and Sauid Arabia, for example, discounts of 17% off posted prices were offered to Aramco. Since the royalty of 12.5% and the income tax due were calculated on the basis of the posted price, the effect of a discount from the posted price was great. However, the lower price did allow for market penetration by Iran.

20. Deductions, in the form of discounts, were provided to the subsidiaries. The effect of this deduction was that many susbsidaries reported no income upon which the 16% royalty was payable.

21. The effect of control of the posted price by the international oil companies was shown in February of 1959 when an 18 cent cut per barrel was introduced and was followed by an additional cut of 10 cents per barrel in 1960. The restoration of pre-1960 posted prices was not achieved until 1970.

22. The following example illustrates this point:
Total value of oil production after costs = $100
Tax at the rate of 50% would equal $50
The royalty as a credit would make the tax rate equivalent to 37.5% or $37.50
Total tax payable would equal $37.50 + $12.50 (the royalty) or $50
Royalty as an expense:
Total value ofproduction after costs (excluding royalty cost) = $100

Royalty expense = $12.50
A 50% tax is then imposed on the difference which is equal to 50% of $87.50 or $43.75.
Total Revenue = $43.75 + $12.50 or $56.25
This figure represents an additional yield to the producing country of $6.25 or 10.6%

23. B. Shwadran, The Middle East, Oil and the Great Powers (1973) 161

24. See note 21

25. The full text of ISPA can be found in the Middle East Economic Survey (Supplement), vol. XV1, no. 4, July 27, 1973

26. Article 6 (a) (3) of the ISPA

27. Article 6 (c) (1) of the ISPA

28. The Iranian corporate tax rate was readjusted from 50% to 55% in November of 1970.

29. After the expense of finding and processing the petroleum one is left with, for example, $100 in value of production. The royalty of 12.5% leaves $87.50. The tax rate of 55% gives the Iranian government $48.12. The $48.12 and the $12.50 royalty payment provides the Iranian government with $60.62 for every $100 of production. To this figure must be added the interest payment which is non-deductible. The effect of all of this is to establish a return to Iran in excess of 60% of the profits of the Consortium members.

30. Article 2 (b)

31. One should note that in the Consortium Agreement little mention of natural gas was made in Article 11 of the agreement specified that the price per 1000 cubic meters was to equal 5% of the posted price of one cubic meter of 37° - 39° A.P.I. crude oil.

32. Article 15 (a)

33. Article 12

34. Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions, supra n. 4 at 157

35. Soon after the Shah was removed, the Iranian cut their production of crude oil, cancelled all existing agreements, and marketed the majority of their crude oil on the spot market in order to obtain higher prices.

Chapter 4

The Iranian Joint-Ventures: 1957-1973

Recent developments in Iran have indicated that Middle Eastern producers of crude oil can effectively manage the marketing of their crude oil without the assistance of the international oil companies or the independent oil companies. It is clear that the problems that might ordinarily be encountered in marketing petroleum are absent owing to the present unprecedent demand for crude oil. However, the present marketing situation only came into existence in 1973 with the embargo.[1] Between 1951 and 1973 the Middle Eastern states, and particularly Iran, solved the dual problems of marketing and foreign control by forming joint-ventures between the national oil company of the state and the foreign oil company as equal partners.

The Background to the Joint-Venture Agreements

Perhaps the single most important factor responsible for the change in design of concession agreements is the increase in world demand and consumption of oil.[2] This factor of increased consumption is of utmost importance (from the point of view of this thesis) because the resulting demand for petroleum has altered the balance of power between the state on the one side and the oil companies on the other. The increase in consumption of petroleum by the West and the fact that alternative fuels are not yet practicable make the bargaining position of the host states practically impregnable.

A second factor that has changed the design of the concession agreement is the introduction into the Middle East of new legal and economic concepts that have altered the basis on which these contracts are negotiated. The legal concept that has been introduced is the idea that the host state can exert sovereignty over a concessionnaire even though a contract between the parties has been signed.[3] Such an idea was especially attractive to governments of the Middle East who knew that they would in all likelihood be toppled from power if they did not maintain control over the oil companies operating within their boundaries. The economic concept that has been introduced into the negotiating process is the idea that the development of a state's petroleum resources must at all times be in the interest of the host state.[4]

A third factor that has changed the design of the new agreements is the rise of the independent oil company as a significant player in the Middle East. The entry of the independent into the Middle East has provided the various states with significant benefits. First, the entry of the independents has resulted in greater economic and political fredom for the host state. By allowing the entry of the independents, a state is not dependent upon a single company to such a degree that the national interests of the host state are imperiled.

A second benefit provided by the independent oil company was the stimulation of competition. Competition led to an acceleration of oil discoveries and the rapid developmentof new concessions. The rapid development was caused not only be increased demand but also because of the requirements of the agreements.[5]

A final benefit that the independent oil companies can provide for the state is technological, marketing, and financial innovation.[6]

Iranian Participation in the Joint-Venture

The first country to participate in a joint-venture in the Middle East was Iran. When one considers the history of Iranian oil policy from 1901 to 1957, when the first joint-venture was signed, this initiative in participating in the joint-venture should not be surprising. Dr. P. J. Stevens has put forth four reasons which account for the development of the joint-venture in the Middle East: the obsolescence of the traditional concession agreement, the availability of new acreage, the limited ability of the host state to develop resources alone, and the rise of the independent oil companies.[7]

In Iran's case there was no question about the inability of the traditional concession agreements to fulfill her political and economic needs. During the years preceeding the first joint-venture, Iran had undergone a great deal of turmoil, both political and economic, owing to the nationalization of Anglo-Persian. The result of that turmoil had been the Consortium Agreement. The Consortium Agreement was not a traditional concession agreement owing to its profit sharing formula and the control exercised by the NIOC. It is clear that if Iran would not settle for a traditional concession agreement with the international oil companies, she surely would not accede to granting such a concession to the independent oil companies.

The second factor which made Iran a likely participant in joint-venture agreements was that much new acreage was available for exploration purposes. Under the terms of the Consortium Agreement, a condition of renewal of that agreement was the relinquishment by the Consortium of 20 per cent of the area of the concession and a further 20 per cent upon the granting of a second renewal. As events developed between the Consortium and Iran, this relinquishment was increased to 25% of the area of the concession and was imposed by Iran in 1964 and not 1979. Further, since the Consortium concentrated its efforts in southern Iran much of the potential oil bearing areas had not been explored. This left Iran with a relatively large area that could be offered to independent oil companies.

The third factor which attracted Iran to the concept of the joint-venture was that the National Iranian Oil Company lacked the expertise to undertake the development of petroleum reserves by itself. The NIOC was formed in 1951, two days after the nationalization of Anglo-Iranian had been approved by the Iranian Parliament. By 1957 the NIOC was an established company but it did not have the resources and ability of the international oil companies.[8] Under the terms of the Consortium Agreement the NIOC supervised, but did not actually direct, the development of petroleum reserves. This was left to the Operating Companies formed by the Consortium members. Therefore the NIOC still required foreign expertise in its own petroleum exploration and producing activities.

The final factor which drew Iran to the concept of the joint-venture was that partners were available. During the 1930's the Iranians were in a position, by the terms of the 1933 Concession, to grant development rights in northern Iran. Interest in northern Iran by other oil companies did not develop because of the involvement of the British government in the affairs of Iran.[9] However, the end of the Second World War witnessed the rise of the independent oil company in the Middle East.[10] These independent companies became the partners that Iran sought.

Difficulties Faced by Iran and the NIOC

When the NIOC first became involved with joint-ventures in 1957, the difficulties she faced influenced the terms of the agreements significantly. First, the NIOC was faced with the task of exploring an area of 500,000 square miles with all its attendant expense and risk. The NIOC, by the terms of the Consortium Agreement, was able to conduct oil operations in the area held by the Consortium only if such production that resulted was unsuitable for export. The main activitives of the NIOC were directed therefore to those areas where no significant discoveries had been made. This greatly increased the risk and thus the cost of NIOC operations. These difficulties (risk and cost) came at a time when Iran was industrializing, a factor which made capital and its allocation of crucial importance. The joint-venture offered a solution to these difficulties because the risk and expense would be shared between the NIOC and a foreign partner. The parimary burden of both the expense and risk was to be upon the foreign partner.

The Petroleum Act of 1957

The legal authority for the creation of the joint-venture in Iran was the Petroleum Act of 1957.[11] The Petroleum Act of 1957 set out the operating relationship, duties, and financial relationship among the parties.

Operating Relationship

Article 6 of the Act required that the NIOC acquire not less than thirty per cent of the ownership interest in any joint-venture.

Duties Under The Act

The Act allowed the NIOC to require the partner to the joint-venture to assume all expenses of exploration and development until commercial production was achieved. The Act also required the development of the concession within a specified period of time. If Iranian participation was equal to or greater than fifty per cent, a well had to be drilled within four years from the date of the agreement and commercial production achieved within twelve years or the concession reverted to the NIOC.[12] If Iranian participation was less than fifty per cent, a well had to be drilled within five years and commercial production achieved within twelve years or the concession reverted to the NIOC.[13]

The Financial Relationship Between The Parties

The royalty and taxation provisions under the Act were similar to those found in the Consortium Agreement. The Act did, however, grant the NIOC authority to charge an annual rental for the area of the concession.

The Relinquishment Provision

The Act specified that half of the area of the concession had to be returned to the NIOC within ten years of the date of the agreement.

The NIOC and AGIP Mineraria Joint-Venture

The first joint-venture in the Middle East involved the NIOC and AGIP Mineraria, a subsidiary of ENI, the Italian national oil company, and was concluded on August 24, 1957.[14] The agreement closely followed the requirements set out by the Petroleum Act of 1957.

The Relationship Between the Parties

A company called the Iran-Italian Petroleum Company (hereafter SIRIP) was established by the agreement. The company was to undertake to explore for and produce petroleum and was to be supplied with capital by AGIP and the NIOC in equal shares. It is noted that the company formed (SIRIP) was independent of both NIOC and AGIP.[15]

The Terms of the Concession

The term of the agreement was to be twenty-five years from the date that the sale of oil began. If a commercial field was not brought in by the end of the twelfth year from the date of the agrement, the concession was to terminate. Accordingly, it was possible by the terms of the agreement to have the concession continue for a period of thirty-seven years at a maximum and twelve years at a minimum.

The Area of the Concession

The agreement provided AGIP with the right to explore for and produce petroleum from an area of 22,900 square kilometers. Article 26 of the agreement limited this grant somewhat for at the end of the fifth year of the agreement, twenty-five per cent of the area was to be returned to the NIOC and at the end of the ninth year of the agreement an additional twenty-five per cent of the original concession area was to be returned to the NIOC. At the end of the twelfth year of the agreement only comercially exploitable fields were to be retained.

Financial Provisions

The royalty and taxing provisions of the agreement were similar to those found in the Consortium Agreement. Of the net profits determined in accordance with the Iranian Income Tax Law of 1949, half of the net profit of SIRIP was paid to the Iranian government and the remaining half equally divided between the NIOC and AGIP.[16] A royalty of 12.5% was payable as well but was to be used as a credit against the fifty per cent tax rate. The effect of the entire taxing scheme was to return one quarter of the net profit to the investor-developer.

Other Provisions of the Agreement

Under Article 8 of the agreement, AGIP undertook to assume the entire cost of the exploration program. If petroleum in commercial quantities were found, the cost of the exploration program was to be evenly divided between the NIOC and AGIP with AGIP receiving a credit for its account with SIRIP.[17] If commercial production were not achieved AGIP was to bear the expenses of both itself and the NIOC.[18] By Article 19 of the agreement, AGIP was required to spend no less than $22 million U.S. during the twelve year term of the agreement. In addition, once a commercial discovery was made, AGIP was required by the terms of the agreement to advance to SIRIP sufficient capital for the exploration and development of other fields.

Summary

In summary, the AGIP agreement was designed to meet the circumstances that Iran faced in 1957—a large unexplored area and a shortage of capital and technology. It is clear that these difficulties were surmounted by the agreement, for Iran only risked half of the initial capital in the company created to manage the joint-venture and nothing else. All exploration expenses were to be advanced by AGIP and reimbursement of these expenses was contingent upon the discovery of petroleum in commercial quantities. Reimbursement was to take the form of a payment of 10 cents per barrel of crude oil exported until the account was settled.

This agreement contrasted markedly with the original concession granted to William D'Arcy in 1901. One notes that the term, area and financial returns to Iran were all significantly weighted in favor of that state. Iran was able to make such a favourable agreement for a number of reasons. The first explanation is that the foreign company, having been incorporated in 1953, was a relatively new participant in the international oil business. A source of supply of crude oil was needed by ENI and the agreement provided this. A second reason for such a favourable agreement was that ENI was effectively excluded from most of the proved concessions in the Middle East. The joint-venture with Iran offered the means by which ENI could develop its own source of crude oil.

The Pan American and NIOC Joint-Venture

The second joint-venture agreement involving the NIOC was signed in April of 1958 and involved the Pan American Petroleum Corporation.[19] The structure of this joint-venture agreement was similar to that created by the AGIP agreement in that the operating company formed was owned equally by NIOC and Pan American. The company formed was called the Iran Pan American Oil Company.

The Term of the Concession

The term of the concession was to be twenty-five years from the date commercial production was achieved. Three renewal periods of five years each were provided by the terms of the agreement. As in the AGIP joint-venture, a commercial field had to be developed within twelve years from the signing of the agreement or the agreement terminated.

The Area of the Concession

Iran Pan American was granted anarea of 16,000 square kilometers upon which to conduct operations. At the end of five years from the date of the signing of the contract the area of the concession was to be reduced by 25 per cent.. At the end of the next five years the area was to be reduced by an additional 25 per cent. At the end of the twelfth year, the area of the concession was to be limited to producing fields.

Financial Provisions

Instead of being subject to a royalty of 12.5 per cent, Pan American was obligated to pay an annual rental per square kilometer of the concession area commencing on the thirteenth anniversary date of the agreement.[20] In addition, Pan American was required to pay a cash bonus of $25 million U.S. within thirty days of the signing of the agreement.[21] The requirement of a bonus of this magnitude was unprecedented in concession agreements. Pan American was also required by Article 30 (2) of the agreement to expend $82 million U.S. on exploration for petroleum over a period of twelve years. In order to assure that this sum was spent, the NIOC by authority of Article 30 (5) was entitled to one-half of the unexpended balance at the end of the twelfth year of the concession.

Tax Liability

Under the terms of the Pan American agreement each party was allowed 50 per cent of the petroleum produced.[22] The tax liability of Pan American was based upon Article 31 of the agreement. Under this article Pan American's gross income would equal the value of 50 per cent of the production, the price of which was to be determined by the posted price less discounts. From gross revenue would be subtracted 10 per cent of the bonus payment over ten taxation periods, rental payments, and depreciation of capital goods.[23] It is important to note that exploration expenditures were not deductible from gross income but were to be repaid to Pan American, when commercial production was achieved, at the rate of "not less than the equivalent of 10 cents per barrel of all petroleum exported."[24]

Summary

There is a clear indication that Iran, through the NIOC was more interested in drawing immediate benefits from Pan American than from AGIP. One need but note the requirement of an immediate payment of $25 million U.S. and the expenditure on exploration over the first four year period of $34 million U.S. It is evident that the above cash requirements were designed to assure the continued development of Iran's industrialization program and to force Pan American to expedite its exploration activities.

The ERAP-NIOC Joint-Venture

The third agreement to be discussed became effective on December 12, 1966, and involved the NIOC and Entreprise de Recherches et d' Activities Petrolieres (hereafter ERAP), the French national oil company.[25] This agreement is discussed because it represents a significant evolution in terms of joint-venture agreements.

The Structure of the Joint-Venture

The most notable variation in the terms of the ERAP agreement was that the NIOC retained overall responsibility for decisions and was the sole owner of all petroleum produced. The object of the agreement was defined in this manner:

> The parties hereby enter into an agreement for technical, financial and commercial services to be rendered by ERAP.[26]

One can consider this agreement a joint-venture, though, and not merely a service contract because the NIOC guaranteed to ERAP "the sale, at an agreed price, of certain quantities of crude oil produced during the life of the commercial fields exploited under this Agreement."[27]

The Exploration Provisions

The provisions relating to exploration and the expenses of exploration in the ERAP agreement were similar to those found in the AGIP and Pan American agreements. Differences existed, though, as to the time allowed for exploration, the area to be explored and the terms of the exploration period. The ERAP agreement was much more sophisticated in its approach to these areas of the agreement.

The concession area covered both offshore and onshore acreage. Under Article 13, which dealt with the exploration of the offshore area, the exploration period was divided into two phases of three years each. During the first year seismic surveys had to be undertaken and during the second and third years three wells had to be drilled.

ERAP was required to maintain a minimum offshore exploration budget of 15 million French francs per year during the second three year period.[28] It is to be noted that there was no minimum amount to be expended during the first three year period.[29]

Article 15 dealt with the exploration of onshore areas. The initial exploration period was to be divided into two phases, one of four years and the second of two years. During the first four year phase, geological work, seismic work, and a minimum of three wells had to be drilled. The second phase necessitated continued exploration activities and the expenditure of a minimum of 10 million French francs per year.

The Relinquishment Provisions

Offshore

At the end of the first year the area of the offshore concession was to be reduced by 50 per cent and at the end of the third year, the area of the remaining part was to be reduced by one-third which left ERAP with 33.3 per cent of the original area.[30]

Onshore

The area of the onshore concession was to be reduced consecutively. At the end of the first year of the concession, the area of the concession was to be reduced to 20,000 square kilometers.[31] At the end of the first phase, the area was to be further reduced to 10,000 square kilometers; and if operations were continued into a third phase, the area of the concession was to be reduced to 7,500 square kilometers.[32]

The essential differences between the ERAP contract and the AGIP and Pan American contract are this time element for exploration and the relinquishment of the concession area. Under both the AGIP and Pan American contracts, 25 per cent of the area under contract had to be returned after the fifth year; a further 25 per cent after the ninth year, and all but the producing fields after the twelfth year. Under the ERAP agreement, by the end of the third year 66.6 per cent of the offshore areas and an equivalent area of the onshore concession had to be returned to the NIOC.

National Reserves

The ERAP agreement introduced into the Middle East the concept of national reserves. Under Article 21, 50 per cent of the discovered recoverable reserves were excluded from the terms of the agreement. This concept was particularly innovative because the NIOC was using both the capital and the technological expertise of ERAP to increase national reserves at no expense to itself.

Financial Terms

ERAP was required initially to provide all of the funds necessary to finance the exploration and development programs; however, ERAP was entitled to recover this sum from the NIOC. Exploration loans were repaid to ERAP either at the rate of 10 cents per barrel of oil produced or by amortizing the expenses at the rate of 1/15 per year.[33]

The development loans were to be repaid by the NIOC with interest and at a much more rapid pace but again the NIOC benefited. First, the interest rate to be paid was equivalent to the prime rate of the Banque de France plus 2.5%. Second, the amount of money upon which interest was payable was rather minimal.[34]

The Purchase Price of the Crude Oil Produced

The purchase price payable by ERAP for the crude oil was perhaps the most clear indication that the NIOC was actually directing the venture. The price payable was equal to the sum of six components—an amount corresponding to the yearly amortization expenses; an amount corresponding to the yearly amortization of the expenses incurred by NIOC in providing geological documents to ERAP at the start of the concession; an amount corresponding to the yearly amortization of appraisal and development expenses; an amount equal to operating costs per barrel which sum included transport, storage, and loading costs; an amount equal to 2 per cent of the sum of the above four components and finally, an amount equal to fifty per cent of the difference between the realized price and the sum of the first four components. The realized price referred to above was equal to the "f.o.b. selling price of crude oil delivered and sold to third parties in the Persian Gulf."[35]

The Quantity of Crude Oil Available to the ERAP

Article 29 dealt with the guaranteed sale to ERAP of certain quantities of crude oil. ERAP was to receive from 35 to 45 per cent of production from each field over a period of twenty-five years. The percentage of oil available to ERAP (from 35 to 45 per cent) was based upon the distance of the field from the sea terminal. ERAP was to receive 45 per cent if the field was 500 kilometers or more from the terminal and 35 per cent if the distance was 100 kilometers or less.

Aside from the crude oil that was available to the ERAP under Article 29, three million tons per year during the first five years after commercial production was achieved and four million tons during the next five years were also available to the ERAP.[36] The price to be paid by ERAP was equal to the realized price (i.e. the market price of crude oil in the Persian Gulf) less a brokerage fee of 2 per cent.

The interesting part of this article related to the provision (section 4) which stipulated that the proceeds of sale were to be used by Iran to purchase French goods and services. Therefore, even though ERAP was paying the market price for crude oil instead of the price calculated under Articel 29, the potential benefits to the French economy would more than outweigh this cost. In addition, a greater supply of crude oil was guaranteed to ERAP and this was the whole purpose of the agreement.

Summary

In summary, the ERAP agreement was a new development in joint-ventures because the NIOC exercised virtual control over the operations of ERAP. It is evident that the demand for petroleum by ERAP was such that Iran could exact maximum benefits from the company.

The INPECO Joint-Venture

The final joint-venture agreement to be discussed was concluded between the NIOC and a consortium of four Japanese oil companies and Mobil Corporation and was ratified on January 5, 1972.[37]

The Relationship Between the Parties

As in all previous joint-venture agreements, a joint structure was formed to conduct operations undertaken by the parties to the joint-venture. In this case, the company formed was called the Iran-Nippon Petroleum Company (hereafter INPECO). The expenses incurred in the operations of INPECO were to be shared equally between the parties to the agreement.

The Exploration Provisions

Under the terms of the INPECO agreement, the consortium was required to spend $52 million U.S. on exploration operations over a nine year period. The innovations introduced by the INPECO agreement in this area were two-fold. First, the companies had to deliver to the NIOC a letter of credit in the amount of $21 million U.S. as a guarantee for the completion of the exploration activities during the first three year period.[38] Second, if a commercial field was discovered before exhausting the first period's allocation of exploration funds, the NIOC was to receive one-half of the unexpended balance.[39] This provision was designed to mitigate any excessive return on the part of the companies. The provision also assured that the Iranian economy would benefit from the multiplier effect resulting from such an expenditure.

The Relinquishment Provision

The INPECO agreement embraced, as did the ERAP agreement, the concept of relinquishment. By the third year of the agreement, 25 per cent of the area of the concession was to be returned and by the fifth year an additional 25 per cent of the area of the concession was to be returned. Furthermore, all of the area of the concession was to be returned by the ninth year unless production in commercial quantities had been achieved. Even if such production were in fact achieved, only producing fields would be retained.

The Financial Provisions

The Royalty Provisions

The financial provisions of the INPECO agreement introduced many new fiscal concepts to the joint-venture in Iran. Article 23 was concerned with the royalty payable by the consortium for the crude oil exported. Unlike previous joint-venture agreements or the Consortium Agreement, the royalty was based upon the foreign investors' cumulative amount of production. A royalty of 12.5 per cent of the posted price was payable until a cumulative amount of 50 million barrels was reached; a royalty of 14 per cent of the posted price was payable until a total of 75 million barrels was reached and finally, a royalty of 16 per cent of the posted price was payable after a cumulative total of 75 million barrels was reached. As a result of Article 25, Iran increased its share of the profits from the operation considerably because they royalty was both expensed and incremental.[40]

The Bonus Payments

A second innovation that one notes in the INPECO agreement was concerned with the bonuses payable by the foreign participants to the NIOC.[41] Under previous joint-venture agreements, a bonus was payable to the host state upon the signing of the concession. The innovations noted in the INPECO agreement concern the time of payment, the circumstances of payment, and the party responsible for payment. A bonus of $35 million U.S. was payable by the parties to the NIOC within thirty days of the signing of the agreement. An additional sum of $5 million U.S. was to be paid by Mobil Corporation alone. Once commercial production was achieved, an additional sum of $5 million U.S. was to be paid to the NIOC; and upon realizing a cumulative production of 100 million barrels, a further bonus of $5 million U.S. was to be paid.

The Rental Provisions

A provision relating to the rental of the concession area appeared in the INPECO agreement as it appeared in the joint-venture agreement involving Pan American. A clear difference exists, though, for in the Pan American agreement a rental per square kilometer was paid in lieu of a royalty of 12.5 per cent. Under the INPECO agreement, a rental per square kilometer was to be paid upon the concessionnaire's achieving commercial production in addition to the payment of a royalty per barrel of oil exported. This rental payment increased dramatically over the life of the contract.[42]

The Tax Provisions

Tax provisions relating to the venture were contained in Article 26 of the agreement. Article 26 provided that the stated payment (i.e. the royalty), rental payments, and any amount paid to the NIOC for its share of crude oil was to be deducted from gross income. Current costs were therefore to be expensed. The Article required, though, that bonus payments, exploration payments, and capital expenditures be amortized over a period of ten years. While the bonus payments and exploration expenditures were to be repaid to the companies by the NIOC, the repayment was made over a lengthy period and no interest at all was to be paid by the NIOC for the use of these funds.

Other Significant Financial Provisions

Posted Price

Posted price was defined in Article 1 (I) as the "f.o.b. price published for each gravity of crude oil offered for sale to buyers generally, which price shall be a price established in accordance with Article 20 on the basis of the prevailing posted prices for Crude Oil in the Persian Gulf with due regard to geographical location and API gravity." This provision was of importance because posted prices in the Middle East were artifically high and the price actually paid was determined by the size of the discount given from the posted price. Under the INPECO agreement, however, no discount was applicable to the foreign investors' share of the petroleum produced under the agreement.[43] Iran derived a much greater return per barrel of crude oil exported owing to the fact that discounts were not granted.

The Division of the Crude Oil Produced

A second provision of financial importance was concerned with the division between the parties of the petroleum produced. Under the terms of the agreement, each party was allocated fifty per cent of the crude oil available for export, but the NIOC was entitled to not more than 10 per cent of INPECO's production for internal consumption.[44]

Article 18 required the companies to purchase the NIOC's share of production if the NIOC elected not to take its 50 per cent share in kind. The price payable to the NIOC for this crude oil was equal to the volume taken multiplied by one-half of the yearly average posted price plus the unit production cost and a percentage of the interest payable by the NIOC for the capital provided to the NIOC by the companies for the financing of the development of the commercial fields.

The definition of the yearly average posted price is self-explanatory. Unit production costs were exploration costs and costs incurred by INPECO in managing the joint-venture calculated on a per barrel basis. Cash bonuses, rentals, and stated payments would not form part of the unit production costs. The interest calculation referred to above would have become a factor in the cost formula if the consortium members advanced the NIOC's share of the cost of developing commercial fields.[45]

Summary

In summary, the INPECO agreement was of importance because the provisions contained in the agreement represented a refinement of earlier joint-venture agreements. These refinements included bonuses payable initially as well as when certain levels of production were reached. The rapid relinquishment and development provisions precluded the consortium from delaying development. The tying of the royalty payable to production levels represented a major change from previous concession agreements. The payment of an annual rental per square kilometer in addition to the requirement of a payment of a royalty and the provision relating to prices calculated on the basis of the posted price without discounts were equally innovative.

Conclusions

After the 1973 Arab oil embargo, the Middle Eastern producers found themselves in a position of power with respect to the independent companies that was not unlike the position of the British during the early stages of the D'Arcy Concession. Iran was certainly under no compulsion to accede to a disadvantageous concession with any of these companies. Sufficient oil revenues were already being obtained from the original Consortium members. Iran was receiving an immediate return on oil investments owing to the practice of requiring a bonus for each concession granted. Finally, there was no difficulty in marketing whatever quantity of petroleum Iran could produce. The advantages once offered by the international oil companies and the independents were no longer required by Iran. Owing to this situation, the service contract became the primary vehicle of foreign participation in the Iranian oil industry.

The Service Contract

A service contract differs from a joint-venture in that the contractor, under a service contract, is not subject to the payment of Iranian income tax because he is in effect a buyer only.

The Ultramar-NIOC Service Contract

In August of 1974, approximately ten months after the Arab oil embargo was imposed, the NIOC entered into a service contract with Ultramar Company, Limited (hereafter Ultramar), a British oil company.[46] The terms of the agreement are quite interesting because they leave no doubt that Iran was fully directing the oil industry operating within its boundaries. When considering Iran's reasons for granting this particular service contract, one should remember that in 1973 the NIOC took over complete operation of the fields and refineries held by the Consortium. The granting of a service contract to a company would allow the NIOC to allocate its capital, expertise, and men to an area whose commercial value was proved, namely the former Consortium area of southeastern Iran.

Differences Between The Ultramar Service Contract and Joint-Ventures

The differences between the Ultramar service contract and a joint-venture such as the INPECO agreement are striking. As a service contract was involved, there was no relinquishment period over which area granted must be returned to the NIOC. Instead, Ultramar had a five year period within which a commercial field had to be established or the service contract came to an end. If a commercial field was established, the contractual relationship between the parties was to extend for a period of only fifteen years.[47] No renewal provisions were contained in the contract.

Another significant difference between this service contract and the INPECO agreement concerned the manner of calculation of the price payable by Ultramar for the crude oil produced. Under joint-venture agreements, the usual price payable was equal to the posted price less costs plus 50 per cent of the profits of the foreign partner. Under the service contract the profits of the foreign partner were not a factor in the calculation of the price payable as the contractor was not the owner of the crude oil produced. The contractor was merely the purchaser.

In determining the price payable under the Ultramar agreement, exploration expenditures, bonus payments, and development expenditures were amortized over a ten year period at an annual rate of 10 per cent. In addition, discounts were applicable to the price payable for crude oil "as an acknowledgement of the risk taken by the General Contractor in respect of Exploration Expenditures."[48] The sum of the above was deducted from the market price to arrive at the sum payable. The factor of importance was that the agreement used market price as a point of calculation and not posted price. Market price in this context meant the price established by O.P.E.C. The contractor was given the opportunity to purchase fifty per cent of the quantity of crude oil produced.

Other Significant Provisions

An innovation introduced by the Ultramar contract was a provision requiring, in effect, the development of any commercially viable natural gas that was discovered. Article 16 (3) states that the contractor "shall undertake to finance all expenditures required for the development and processing and delivery of such Gas up to the starting point of the processing plant." Again the contractor was entitled to purchase a certain percentage (the amount was not specified) of the products from the processing plant for a period of fifteen years. The innovation that the NIOC introduced into this agreement was that if Ultramar did not wish to expend the necessary funds to develop and process the gas, then the exploration expenditures for such field were not recoverable unless another commercial field was developed.[49] Unless Ultramar discovered a field in which significant quantities of natural gas were present, then Ultramar really had no option but to develop the natural gas.

Summary

The Ultramar service contract suggested that the position of Iran vis-a-vis the oil companies operating in the Middle East had certainly changed since the D'Arcy Concession was signed in 1901. By utilizing the service contract, Iran benefited enormously. The foreign company assumed all of the risks involved in searching for, developing, and processing petroleum and natural gas over a defined period of time. In return the foreign company was afforded the opportunity to purchase some of the petroleum and natural gas at world prices. In this manner both parties derived substantial benefits. Iran's resources were developed under its direction and at no risk or cost to itself and the foreign company secured a supply of crude oil and natural gas.

Footnotes Chapter 4

1. The Arab oil embargo was imposed in October of 1973 in the midst of the fourth Arab-Israeli War. The effect of the embargo was immediate as shortages of oil resulted in the West. In conjunction with the embargo the price of oil was raised from $3.01 to $5.12 per barrel. Since the embargo, the price of oil has continued to rise and is presently $40.00 per barrel.

2. H. Cattan, The Evolution of Oil Concessions in the Middle East and North Africa (1967) 5

3. P. J. Stevens, Joint-Ventures In Middle East Oil (1976) 7

4. *id.* at 5

5. J. G. McLean, "The Importance Of the Newcomers In the International Oil Business" (1968) X1 (Supplement) Middle East Ecmonic Survey 14

6. *id.* at 16

7. Stevens, Joint-Ventures In Middle East Oil, *supra* n. 3 at 7

8. The NIOC is a major oil company today. The NIOC holds interest in tanker fleets, foreign refineries, and foreign oil producing areas. The NIOC also operates the petrochemical industry in Iran as well as the marketing of all petroleum porducts in Iran.

9. *See* chapters 2 and 3 of this thesis.

10. The independent oil companies did exist in the 1930's (for example, Continental Oil Company, which was incorporated in 1920) confined their efforts to the North American continent. Major American oil companies confined their interest to non-British areas. The Saudi concession granted to ARAMCO is one such example. This situation changed after the second world war as the demand for petroleum grew greater and greater.

11. The full text of the Petroleum Act of 31st July, 1957 is found in 1 Middle East Basic Oil Laws And Concession Contracts (1960) Iran-A 2

12. Article 7 (b)

13. Article 8 (e)

14. The text of this contract is found in 1 Middle East Basic Oil Laws And Concession Contracts (1960) Iran-D-1

15. This independence is illustrated by Article 12 which in part reads as follows:

> SIRIP undertakes to offer for sale to NIOC and AGIP Mineraria prior to anyone else any amount of petroleum which it can dispose of. In the case that both the NIOC and AGIP Mineraria are not prepared to buy that oil on terms acceptable to SIRIP that latter Company must sell it to other buyers on terms not less acceptable to SIRIP.

16. Article 17. The NIOC is a taxable entity but is totally owned by the Iranian government. Therefore the Iranian government receives approximately 3/4 of the net profits of the operation.

17. Articles 9, 10 and 11

18. Article 8

19. The text of the contract is found in 1 Middle East Basic Oil Laws And Concession Contracts (1960) Iran-B-1

20. Article 30 (8). The Petroleum Act of 1957 by section 9 (a) authorized the substitution of an annual rental for the stated payments of 12.5%.

21. Article 30

22. Article 24 (1)

23. Article 31 (5)

24. Article 15 (11)

25. The text of the contract is found in Supplement 15 Middle East Basic Oil Laws And Concession Contracts (1967) A-O

26. Article 3

27. Article 3 (d)

28. Article 18 (3)

29. However, under the terms of Article 13 (2) (a), ERAP was required to complete 6,000 kilometers of seismic lines and drill a maximum of three wells. This was, in effect, a requirement that a minimum amount of funds be expended.

30. Article 14 (2) provided, in addition, that if the exploration activities were continued into a third phase, which was possible if the NIOC so requested under Article 13 (4), then the area of the concession would again be reduced by one-third. This would leave ERAP with only 29% of the original area of the concession.

31. Article 16 (1)

32. Article 16 (2)

33. Article 27 (1)

34. The amount of money upon which interest was payable was much less in the development stage because a commercial field was involved. The exploration period did not end until a commercial well had been drilled and tested (Articles 18 and 19). Therefore most expenditures upon which there was no interest payable will have been made in the exploration phase and not during the development phase. Accordingly, all expenses incurred by ERAP until a commercial well had been drilled and tested were considered as exploration loans and all monies advanced after this stage were development loans.

35. Article 30 (1) (a)

36. Articles 30 (1) (a) and (b)

37 The text of the INPECO agreement is found in (1972) 15 Middle East Economic Survey

38. Article 25 (6)

39. Article 25 (7)

40. The following figures show the effect of a royalty of 16%
a. Value of production after deduction of expenses but before expensing royalty = $100
b. Value of production less royalty = $84
c. Tax at 55 % = $46.20
d. Return to the NIOC = $62.20

41. Articles 25 (2) (a) (b) and (c)

42. Articles 25 (8). Rental payments are as follows:
a. Commercial production to the 4th year of the contract = $400/sq. km.
b. From the 5th to the 9th year of the contract = $480/sq. km.
c. From the 10th to the 14th year of the contract = $600/sq. km.
d. From the 15th year to the 19th year of the contract = $780/sq. km. The above years are inclusive.

43. Article 37 (4). A discount may be granted if Mobil and four Japanese companies purchase NIOC's share of the petroleum produce. Under the terms of the agreement they made be obligated to so purchase.

44. Article 21 (1) (c)

45. Article 16 (9)

46. The Text of the contract is found in Supplement 51 Middle East Basic Oil Laws And Concession Contracts (1976) 1

47. Article 15 (1)

48. Article 15 (2) (b). The discount ranges from 4 to 5% and extends over a period of fifteen years.

49. Article 15 (5)

Chapter 5

The Alberta Concession: 1931-1949

It was suggested in Chapter 1 of this thesis that oil concession agreements in Iran evolved through three distinct stages. In the first stage, the investor-developer, William D'Arcy, was able to dictate the terms of the concession agreement because he was negotiating from a position of power. In the second stage, both parties to the concession derived substantial benefits and both parties compromised. In the third and final stage, Iran was able to dictate contractual terms to the investor-developer involved, in much the same way as Iran was dictated to by William D'Arcy in 1901.

Despite the social, political, and economic differences between Iran and Alberta, the same process of evolution occurred in Alberta. When Alberta obtained administrative control over its natural resources in 1930, the province was in the midst of a severe economic depression. The Alberta government required the presence of the oil companies for economic development and as a result of the terms obtained by the oil companies were extremely favourable to them. This state of affairs continued until 1949 when the economic viability of the oil industry in Alberta was firmly established. At this stage of the relationship between the government and the oil companies, both parties to the agreements derived benefits. The Alberta government required the revenues derived from the sale of petroleum and natural gas and the oil companies wished to continue to derive their substantial profits. The third stage in the relationship between the Alberta government and the oil companies was reached in 1973 when the Arab oil embargo was imposed by Middle Eastern states. The embargo enabled the Alberta government to dictate the terms of concession contracts to the companies operating in Alberta because oil had become a scarce and very valuable commodity.

As stated above, Alberta obtained ownership of mines and minerals in the province in 1930 from the Federal government. The fact that the Alberta government owned the mines and minerals enabled it to grant leases of these mineral rights. A lease, like a concession, is a grant of a profit a prendre. Accordingly, the term concession will be used interchangeably with the term lease throughout this chapter of the thesis.

Oil and Gas Rights Granted By the Alberta Government: 1930-1949

It is important to note that in Alberta oil and natural gas rights are granted by virtue of statutes enacted by the Alberta government. These statutes are complemented by various regulations. From 1930 to 1949, The Provincial Lands Act[1] was the statute which enabled the Alberta government to grant oil and gas rights to the oil companies.

The Provincial Lands Act

Section 39 of The Provincial Lands Act provided that:

> (1) Lands containing any minerals, together with the right to win, work and get the same, may be leased in such manner as may be prescribed by regulations made by the Lieutenant Governor in Council.

Oil and Gas Leasing Regulations

Petroleum and natural gas leasing regulations were established on June 18, 1931.[2] These regulations were similar to the concession contracts granted in the Middle East as the following terms were specified in the regulations: the maximum area which could be acquired from the government, the term for which the lease could be held, and fiscal and obligatory provisions.

The Area of a Lease

Under the 1931 regulations the maximum area that could be held under a lease was 1,920 acres while the minimum area that could be held was 160 acres.[3] It should be noted that there was no limitation upon the number of individual leases a single company could obtain.[4]

The Term of a Petroleum and Natural Gas Lease

The term of a petroleum and natural gas lease under the regulations was 21 years and was renewable for a further term of 21 years.[5]

Obligatory Provisions Under the Regulations

Under the Alberta regulations, a lessee had to assume certain obligations dictated by the Minister. Under section 11 of the regulations, the lessee, within one year from the granting of the lease, had to have upon the leased area a quantity of machinery of a value of at least $10,000 to conduct drilling operations. Within this one year period, the lessee had to be in a position to commence drilling operations, yet the drilling of a well was not required.

Section 12 of the regulations stated that the lessee had to commence drilling operations within fifteen months from the granting of the lease or forfeit the lease. The effect of this drilling requirement was somewhat reduced, however, for if the sum of $5,000 was expended by the lessee in drilling activities during the year or fifteen months in question, the lease was extended.[6] Therefore a well did not have to be drilled to completion during this period. This provision suggests that the Alberta government was not in a position to force rapid development of its oil resources.

Rental Provisions

In addition to the above obligations, the lessee was required to pay to the Crown a rental of fifty cents per acre the first year and one dollar per acre for each subsequent year.[7] The total sum involved in the second and subsequent years of a lease would be $1,920 assuming that the maximum allowable acreage per lease was acquired. The regulations provided, however, that extensions could be given for the payment of this rental fee and, in addition, part of the expenditures incurred in drilling were able to be used to reduce the amount of rent due.[8]

Financial Returns to Alberta

The regulations required a lessee to pay the Crown a royalty upon the amount of crude oil sold, and in 1931 that royalty was set at five per cent of sales.[9] It is noted that the company involved would also have been subject to provincial and federal income tax statutes.

Governmental Supervision Over the Oil Companies

A most important observation that can be made about these regulations was the extent of governmental supervision over the drilling activities of the lessee. This degree of control can be shown by examining the following provisions from the regulations.

Under section 29 of the regulations, the Minister was at any time able to "assume absolute possession and control of any location acquired under the provisions of these regulations, if in the opinion of the Lieutenant Governor in Council such action is considered necessary or advisable." While compensation was to be paid to the lessee under this provision, the ability of the government to seize possession was evidence of the control which could be exercised by the Alberta government.

Sections 44, 47, and 58 of the regulations further illustrated this point. Section 44 authorized the Minister "to enter upon the demised premises and to have access to all wells, records, plants and equipment." Section 47 required the lessee to obtain permission from the government before drilling operations were initiated, and section 58 required the lessee to assume the expenses incurred by the government in controlling the escape of petroleum and natural gas.

A final provision which illustrated the degree of control exercised by the government was section 77 of the regulations. This section was the forerunner of the present prorationing scheme and allowed the lessee "to take therefrom only such proportion of the petroleum and natural gas that may be marketed without waste."

Summary: Oil and Natural Gas Leasing Regulations

From a study of the petroleum and natural gas leasing regulations, one can arrive at several conclusions about the policy of the government of Alberta. First, there was certainly no attempt made by the Alberta government to derive maximum revenue from the companies involved during either the exploratory or production stage. The royalty of five per cent which the Alberta government received was less that what Iran received under the terms of the D'Arcy Concession. Furthermore, the requirement that rentals be paid, while not particularly onerous, was practically eliminated by the provision allowing expenditures to be credited against them.

It is evident that the policy of the Alberta government during this stage was to encourage the exploration for and the development of Alberta's resources of petroleum and natural gas. It is also important to note that the Alberta government was not in a position to demand substantial returns or investments from the oil companies involved.

In 1931 Alberta did not possess proved reserves of petroleu, alternative supplies of crude oil were available to the companies involved, and the economic situation that existed in the 1930's necessitated Alberta's obtaining investment in the province at virtually any cost.

Petroluem and Natural Gas Permit Regulations

The petroleum and natural gas leasing regulations were complemented by regulations governing the issue of permits to prospect for petroleum and natural gas.[10] It is noted that a company did not have first to apply for a permit before acquiring a lease, although certain advantages were gained by acquiring a permit initially.

Section 1 of the permit regulations limited the area that could be held under a permit to the same area that could be held under a lease, namely three sections. Furthermore, by section 2 of the permit regulations, regulations governing the granting of a lease were to apply as far as practicable to the granting of permits.

The essential difference between oil and gas leases and petroleum and natural gas permit were concerned with the rental free, the duration of the permit, and the obligations incurred by the permittee upon the granting of the permit. The term of a permit was one year.[11] The rental fee was 10 cents per acre.[12] In applying for a permit the permittee had to include a bond in the sum of 40 cents per acre.[13] This sum had to be expended in exploration activities or the bond provided was forfeited. Before the expiration of the permit, the permittee was able to apply for a lease of the area under permit.[14] Once a lease was obtained, the regulations relating to petroleum and natural gas leases would come into effect.[15]

Changes in the Regulations Between 1937 and 1947

On only three occasions between 1937 and 1947 did significant changes occur in the regulations governing and the disposition of petroleum and natural gas rights.[16]

Crown Reserves

The most significant development was the establishment on March 3, 1937 of Crown Reserves.[17] Section 8 of the Crown Reserve regulations provided that:

> The petroleum and natural gas rights, the property of the Crown in all odd numbered sections of land situate north of the north boundary of Township 52 are hereby reserved and constituted Crown Reserves.

It is important to note that this concept of Crown Reserves was introduced in 1937 at a time when the commercial viability of the Alberta oil industry was still very much in question. In Iran, the concept of national reserves was not introduced until 1966 in the ERAP-NIOC joint-venture agreement.

The Reservation of Petroleum and Natural Gas Rights

The second occasion on which a major change was made in the regulations governing the disposition of oil and natural gas rights occurred on September 5, 1937, when the regulations relating to the granting of permits were cancelled [18] and regulations relating to reservations of petroleum and natural gas rights established.[19] The minimum area of a reservation was 10,000 acres and the maximum area was 50,000 acres.[20] The maximum term of a reservation was nine months.[21] The first period of a reservation extended for 45 days during which previously obtained geological data was assessed. During the next 45 days geological operations were to be undertaken. If the latter geological examination was not completed the term could be extended for an additional six months. A payment of five cents per acre or a maximum of $2,500 was to accompany the application for a reservation.[22]

Section 8 of the regulations allowed the holder of a reservation to submit an application for a lease of the reservation exclusive of Crown Reserves. Expenses incurred in exploring the reservation in excess of 20 cents per acre were allowed as a credit against lease rentals.

The 1941 Changes in the Reservation Regulations

The final major change in the regulations was made in 1941. The maximum area that could be held under a petroleum and natural gas reservation was increased to 200,000 acres.[23] The area that could be held under a lease was increased from 1,920 acres to 9,600 acres.[24] This change in the regulations indicated that the companies operating in Alberta were still in a position of power. A lease covering 9,600 acres would have given a company complete control of an entire pool of petroleum and natural gas.

The 1947 Regulations

After the Leduc discovery in 1947, one witnessed a major surge in interest by the oil companies in the petroleum situated in Alberta. The kinds of interests in petroleum and natural gas that one could obtain from the government of Alberta multiplied.

Oil and Natural Gas Leasing Regulations

The leasing regulations of 1947 [25] are to a degree quite different from the regulations that were in effect in 1931. The term of a petroleum and natural gas lease remained the same at 21 years but the area that could be held under a lease was increased substantially. Under the 1931 regulations the maximum area that could be held under a single lease was limited to three sections, subject to the exception that the assignment of leases were excepted. Under the 1947 regulations the maximum area that could be held under a single lease was increased to 16 sections.[26] This limitation too was subject to exceptions for the regulation stated that this maximum exists "excepting by assignment or in consequences of the Regulations for the reservation of petroleum and natural gas rights."[27] The regulations governing the reservation of petroleum and natural gas rights (which will be discussed in greater detail below) provided that the maximum area of a reservation was 100,000 acres.[28] Section 9 of these regulations allowed the holder of a reservation to apply for a "lease or leases of the whole area or a portion of the tract described in the reservation, exclusive of any Crown Reserves." Therefore it is quite evident that a petroleum company was able to obtain a lease of an area in excess of 16 sections.

Obligations Imposed Upon Leaseholders

The obligations incurred by a lessee under these regulations were much greater than those a lessee would have been subject to under the 1931 regulations. First, under section 11 the lessee was required, within one year from the date of the lease, to install on the leasehold "such machinery and equipment suitable for carrying on drilling operations as the Ministry may consider necessary."[29] One should note there was no dollar limitation upon the value of the machinery that the Minister could require upon the leasehold.

Second, the lessee had to commence drilling operations upon the leasehold immediately upon completing the installation of the machinery referred to above.[30] In addition, should the well be completed or abandoned, the lessee had to begin the drilling of another well within ninety days unless the Minister consented to the suspension of drilling operations.[31] A further obligation was contained in section 11 (e) which required the lessee to drill an offset well [32] within 90 days of a well's coming into production on freehold land.

If one contrasts the obligations imposed under the 1947 regulations with those imposed upon the lessee by the 1931 regulations, several important differences are noted: First, there was no offset well clause under the 1931 regulations. Second, the lessee had to drill a well under the 1947 regulations or lose his lease. Under the 1931 regulations it was possible for a lessee not to drill a well to completion if a "sum of $5,000 had been expended in actual drilling operations by recognized methods."[33] It is evident that if a lessee believed he could bring in a profitable well, he would probably complete the well. Therefore the effect of section 11 may have been nil. However, the situation could have occurred where the lessee had sufficient reserves of crude oil and might not have wished to spend more than the minimum of $5,000 per year set out in section 11. In this situation the option provided by section 11 of the 1931 regulations would have been of paramount importance.

The Crown Reserve Regulations of 1947

A final significant innovation contained in the 1947 regulations was the expansion of the concept of Crown Reserves. Crown Reserves were established, as stated above, on March 3, 1937.[34] Crown Reserves included odd-numbered sections north of township 52, acreages of equal area to leases granted in unsurveyed areas of the province, and forest reserves. The above regulations were modified in 1941 and 15 areas comprising over 14,000 square miles were set aside as Provincial

Reserves.[35] The regulations were again modified in 1944.[36] The number of Provincial Reserves was reduced to 14; [37] areas of less than 160 acres were included; [38] areas of equal dimensions adjoining leases in surveyed territory north of the left bank of the Saskatchewan River were included; [39] and, in unsurveyed territory, an area adjoining a lease of equal dimensions to the lease was included.[40]

In 1947 two further changes of significance were made to the regulations governing Crown Reserves. First, in all surveyed territory, an area of equal acreage was to be set off against a lease granted by the government.[41] Second, in unsurveyed territory, a lease had to be surrounded by four Crown Reserves each equal to the area of the lease granted.[42]

Summary

In summary, what one finds upon analyzing the leasing regulations of 1947 is a governmental policy that was designed to foster the rapid development of provincial reserves of petroleum and natural gas. The drilling obligation imposed by the regulations is proof of this policy. A second policy which can be inferred from the regulations was the preservation of a reasonable supply of oil and natural gas for future development. The Crown Reserve regulations outlined this policy. One also notes that the government was attuned to the realities of the industry for the area which might be held under a single lease was substantially increased.

The Petroleum and Natural Gas Rights Reservation Regulations of 1947

The regulations governing the reservation of petroleum and natural gas rights were substantially modified in July of 1947.[43]

Area

Under the 1937 regulations the maximum area that could be held under a reservation was 50,000 acres.[44] Under the 1947 regulations the applicant was permitted to hold no more than two reservations,[45] each of a maximum of 100,000 acres or 200,000 acres in all.[46]

Financial Terms

Under the 1947 regulations the financial burden on the applicant wishing to obtain a reservation was increased dramatically. A fee of $250 had to be enclosed with the applications as well as a deposit of $750 for each 20,000 ecre area reserved if surface geological operations were to be conducted and a deposit of $2,000 per 20,000 acres is subsurface operations were contemplated. The maximum figure that would be involved for a single reservation if subsurface operations were carried out was $10,750 excluding rental payments. The comparable figure under the 1937 regulations was $2,500.

Obligations of a Reservation Holder

The 1947 regulations specified that an applicant had to conduct a geological examination of the reservation in such a manner than an "expenditure satisfactory to the Minister was incurred for the purpose mentioned." The provision further provided that the deposit, referred to above, could not be refunded until a statutory declaration of expenditures had been made. Under the 1947 regulations, the Minister could determine the expenditures of the applicant. The difference between the 1937 and 1947 regulations that one notes is that the level of expenditures under the 1937 regulations appears to have been dictated by the payment of five cents per acre because this payment was not refundable. The deposits of $2,000 per 20,000 acres or $750 per

20,000 acres under the 1947 regulations were, however, refundable.

Summary: The Disposition of Crown Oil and Gas Rights: 1930-1949

The above discussion indicates that from 1930 to 1949, the Alberta government was not in a position to demand a substantial return from the oil industry. The types of rights granted during this period were varied and all were designed to increase development of the oil and gas industry. It should be noted that during this time span the relationship between the government and the investor-developers was amicable because hugh profits were not being made by the investor-developers. The benefit the investor-developers provided Alberta was investment in her natural resources.

Footnotes Chapter 5

1. S.A. 1931, c. 43

2. Alta. Reg. 669/31

3. id. at s. 2

4. s. 3 of the regulations did provide that a lease could be combined with another lease of 1,920 acres if the second lease was obtained by assignment rather than by direct disposition from the Crown. Accordingly, this maximum of 1,920 acres per lease could be circumvented by a company.

5. Alta. Reg. 669/31, s. 2

6. id. at s. 12

7. id. at s. 2

8. id. at s. 13

9. J. Conder, The Disposition Of Crown Petroleum And Natural Gas Rights In Alberta (1963) 23

10. Alta. Reg. 671/31

11. id. at s. 3

12. id. at s. 5

13. id. at s. 6

14. id. at s. 10

15. One does not encounter major changes in the disposition of Crown oil and natural gas rights until 1936. In that year several changes were introduced by new regulations. The limitation on the area that might be acquired by a permit which was three sections was eliminated and the area of the permit was left to the discretion of the Minister. It is evident that this change was made because it was realized that an area of three sections was an inadequate space upon which to assess the prescent of petroleum and natural gas.

A second change related to the term of a permit. The regulations provided that the term of a permit could be extended for an additional six months in the Lethbridge and Calgary Land Agencies and one year in lands in other parts of the Province.

A third change introduced by the regulations was that a permittee had to commence exploratory activities within ninety days of the granting of the permit or suffer its cancellation. A final change provided in the regulations was that expenditures that would qualify as credits under the petroleum and natural gas lease regulations of 1931 were able to be used as a credit against rentals due under any petroleum and natural gas lease that might be acquired from the permit area.

16. The most important change introduced by the 1936 regulations related to section 17 of the 1931 regulations which concerened the right of the lessee to group his leases if he acquired more than one lease by assignment. Section 17 of the 1931 regulations stipulated that the maximum area that could be grouped was 20,000 acres. Section 4 of the 1936 regulations modified this in that the maximum area of a grouping was increased to 50,000 acres. A further change introduced in 1936 modified the royalty provisions under the 1931 regulations. Under the 1936 regulations, if a well were brought in a previously unproved area, the Minister was able to rebate the royalty that would be payable to the Crown.

17. Alta. Reg. 225/37

18. Alta. Reg. 1027/37

19. Alta. Reg. 1026/37

20. id. at s. 2 (b)

21. id. at ss. 3, 4, 5, and 11

22. id. at s. 2 (c)

23. Alta. Reg. 278/41, s. 3 (c)

24. Alta. Reg. 1213/41, s. 3 (a)

25. Alta. Reg. 860/47

26. id. at s. 3 (a)

27. id. at s. 3 (a)

28 Alta. Reg. 716/47, s. 3 (d)

29. id. at s. 11 (a)

30. id. at s. 11 (b)

31. id. at s. 11 (d)

32. An offset well is a well drilled to capture petroleum from underneath an adjacent well.

33. Alta. Reg. 669/31, s. 12

34. Alta. Reg. 225/37

35. J. Conder, The Disposition Of Crown Petroleum And Natural Gas Rights In Alberta (1963) 26

36. Alta. Reg. 156/44

37. *id.* at s. 2 (c)

38. *id.* at s. 2 (a)

39. *id.* at s. 2 (b)

40 *id.* at s. 2 (d). Forest Reserves were also included by s. 2 (b)

41. Alta. Reg. 716/47, s. 39 (c)

42. *id.* at s. 39 (d)

43. *id.* at s. 39 (d)

44. Alta. Reg. 1026/37, s. 2 (b)

45. Alta. Reg. 716/47, s. 3 (e)

46 *id.* at s. 39 (d)

Chapter 6

The Alberta Concession: 1949-1973

The second stage in the evolution of the relationship between the Alberta government and the oil companies was reached in 1949 when the economic viability of the oil and gas industry in Alberta was no longer in question.[1] The statutes and regulations in force during this period reflect this situation.

The Mines and Minerals Act, 1949

In 1949 The Mines and Minerals Act [2] was enacted and replaced The Provincial Lands Act which had been in force up to that date. The provisions of The Mines and Minerals Act, 1949 bore little similarity to the provisions relating to oil and gas found in The Provincial Lands Act. Three new kinds of acquisition rights were provided in the statute. These included natural gas licences, Crown Reserve natural gas licences, and Crown Reserve drilling reservations. Additional forms of acquisition rights were not encountered until the enactment of The Mines and Minerals Act, 1962.[3]

Natural Gas Licence Regulations

Regulations governing the licencing of natural gas rights were first enacted on January 29, 1951.[4] They were replaced by regulations dated August 21, 1957.[5] The latter regulations continued in effect, with little modification, until 1962.

Under the 1957 regulations, a natural gas licence could be applied for by the holder of a reservation of petroleum and natural gas rights. Accordingly, to obtain a natural gas licence, one had first to acquire a reservation of petroleum and natural gas rights. Before a licence could be granted, a report had to be filed detailing the extent of natural gas found in a zone or zones.[6] If the licence were granted, the natural gas rights to be included in the licence were surrendered out of the reservation. It is noted that the reservation of the remaining petroleum and natural gas rights continued.

The Drilling Obligation

If a licence were granted the licencee was under a drilling obligation that was two-fold. Within three months of the granting of the licence, a well had to be drilled to the zone or zones specified in the report filed with the Minister. If the well were completed or abandoned, the licencee had to drill and additional well within three months.

Area of a Lease Acquired from a Licence

If natural gas was found in commercial quantities, the licencee could apply for a lease of the natural gas found in the zone or zones applied for. The area of the lease was dependent upon the depth of the well drilled and ranged from three sections if less than 300 feet were drilled to ten sections if a well depth of greater than 6,000 feet was reached.

Term of a Lease Acquired from a Licence

The term of a natural gas lease obtained from a licence was 21 years and was renewable for so long as production in commercial quantities continued. The rental per acre was 33 1/3 cents although this rental fee could be reduced to 10 cents if marketing difficulties were present.

Royalties

A royalty of fifteen per cent of the market price was payable to the Alberta government. In no event was the price payable to be less than 3/4 of 1 cent/1000 cu. ft.[7]

Licence Regulations: Summary

Several important observations may be made about the above licencing regulations. The regulations were most assuredly designed to encourage the development and conservation of natural gas reserves. The typical practice of the industry in the early 1930's was to flare natural gas found in association with petroleum. This encouragement to develop natural gas was accomplished by both a minimal royalty and a minimal rental per acre after a lease was acquired. Furthermore, section 24 of the regulations provided that if a licencee or leassee encountered petroleum in drilling for natural gas, a lease of petroleum rights could be obtained. This made the acceptance of a natural gas licence as opposed to an oil and gas lease less risky from the prespective of the oil companies.

Crown Reserve Natural Gas Licences

Crown Reserve natural gas licences were introduced on December 1, 1952.[8] There was not a great deal of difference between the regulations relating to natural gas licences and Crown Reserve natural gas licences. The major differences were that Crown Reserve natural gas licences were auctioned off [9] and the possibility of the acquisition of an oil lease from a licence was much more limited.[10]

Crown Reserve Drilling Reservations

Crown Reserve drilling reservations were first established in 1954.[11] The regulations governing Crown Reserve reservations were similar to the 1937 regulations governing the reservation of petroleum and natural gas rights.[12] The essential differnce was that the Crown Reserve drilling reservation regulations applied to Crown Reserves only. A second difference was that a Crown Reserve drilling reservation was auctioned off and the area to be auctioned off was determined by the Minister. Drilling obligations existed in that a well had to be drilled within one year from the granting of the reservation and a second well had to be drilled if the first well did not yeild petroleum and natural gas in commercial quantities.[13] Once again the governmental policy of requiring greater returns from Crown Reserve lands by the procedure of auctioning is noted. The area that could be acquired by a lessee was at the discretion of the Minister, as stated above, and this factor certainly increased both the power of the provincial government over the oil companies and the amount a lease could command at auction.

The Mines and Minerals Act, 1962

The law governing the disposition of oil and gas rights was substantially modified with the enactment of The Mines and Minerals Act, 1962.[14] The 1962 Act represented a major revision of the law and significant changes in the law did not appear again until after the Arab oil embargo of 1973.

Petroleum and Natural Gas Leases under the 1962 Act

Term

The term of a petroleum and natural gas lease granted after June 1, 1962 was ten years.[15] Under the Mines and Minerals Act, 1949, the term of a petroleum and natural gas leas had been twenty-one years.[16] The shorter term of the lease indicated that the Alberta government was in a position to demand more from the oil companies.

Royalty Provisions

Royalty provisions under the 1962 Act were similar to those contained in the 1949 Act. The maximum royalty payable under both Acts was 1/6 of production during the term of the lease. If existing leases were renewed under the 1962 Act, the maximum royalty provisions were no longer applicable.

Area Held Under a Lease

The prescribed area of a lease under the 1962 Act was a square of nine sections or a rectangle of 8 sections, although a lease did not necessarily have to assume either shape.[17] The statute provided that "where the tract applied for consists of adjoining or cornering parcels, the outer boundaries of the square or rectangle that would encompass the parcels that may be included in one lease, shall not exceed the boundaries of the maximum areas prescribed by section (1)."[18]

At the expiration of the ten year term of the lease, the area subject to the lease was reduced to the spacing unit[19] for each well plus an area which when added to the spacing unit did not exceed one section.[20] If natural gas were discovered and the Minister reduced the rental payable to fifty cents per acre, the area of the lease that could be retained by the lessee at the expiration of the ten year term was equal to the whole of the area of the lease if that area was encompassed by a spacing unit; if the area of the lease were greater than the spacing unit, however, it would be reduced to the spacing unit.[21]

If a well were drilled before the expiration of the ten year term of the lease but was not completed, the lease continued as to that part of the area of the lease that would have continued if the well were a producing well.[22] If the well referred to above was abandoned or another drilled before the expiration of ninety days the lease was similarly continued.[23]

Offset Well Requirement

Under the 1949 Act a lessee was obligated to drill an offset well unless natural gas was being produced and no available market existed. The 1962 Act provided an option and that option was that the lessee could pay a compensatory royalty instead of drilling an offset well.[24]

The Drilling Obligation

A second obligation to which the lessee was subject related to leases held by the lessee which were granted under The Provincial Lands Act and The Mines and Minerals Act, 1949. This would refer to leases granted before June 1, 1962. The Act provided the Minister with the authority to require lessees to commence drilling operations upon those leases upon their reaching a certain duration. For example, the Minister was able to give notice to those lessees who held leases that had reached the end of the fifteenth year of their term before or during 1961.[25] This provision had the effect of terminating those leases of a duration of twenty-one years or more, granted under previous Acts, if drilling did not take place when ordered. Under the 1962 Act, no drilling obligation was imposed upon the holders of ten year leases.[26]

Incentives Offered to Lessees Under the 1962 Act

The Mines and Minerals Act, 1962 provided a number of incentives to the lessee to mitigate the effect of the obligations imposed under the Act. If natural gas was discovered after a petroleum and natural gas lease had been granted by the Minister, the annual rental per acre was reduced from $1 to 50 cents.[27] If a market was available for the natural gas produced, the rental per acre could be further reduced to 25 cents.[28] The absence of a drilling obligation under the Act provided a further incentive for a lessee ws able to hold a lease of nine sections at a cost of one dollar per acre.

The Establishment of Block A

A most significant change introduced by the 1962 Act was the establishment of an area called Block A. Block A consisted of townships 1 to 64 inclusive, west of the fourth meridian. The importance of Block A was that Crown Reserves situated in that area were discontinued and the lands in them were available for lease under the new regulations. These regulations established the procedure for the acquisition of a petroleum and natural gas permit in the Block A area only.[29]

Petroluem and Natural Gas Permits in the Block A Area

The maximum area that could be obtained under a permit was 36 sections or 23,040 acres.[30] One notes that a permit of this size in an area that once included Crown Reserves was rather unprecedented. The regulations did, however, account for the size of the permit granted. Under section 5 of the regulations, former Crown Reserves were auctioned off while areas which were not Crown Reserves were applied for directly under section 4 of the regulations.

The term of a permit was six months although three renewal periods of six months each could be applied for. A rental per acre of 50 cents was charged during the initial term and each renewal period.

There were several sections in the regulations which indicated that the policy of the government in the Block A area was to encourage rapid development. If a well were drilled during the initial term of the permit, a refund of thirty cents per acre of the rental fee was provided.[31] If a well were drilled during the first renewal period, a refund of twenty cents per acre was made, and if a well were drilled during the second renewal period, a refund of ten cents per acre was provided. The regulations also allowed fifty per cent of the expenditures incurred in drilling to be credited against rentals due during the first year of the term of a lease acquired from the permit area.[32]

Leases were obtained pursuant to section 16 of the regulations. To obtain a lease, a lessee had to drill a well to test for the prescence of petroleum and natural gas.[33] Ther permittee was then able to apply for a lease of the entire area held under the permit. It is noted that there was no limit on the number of permits a single company could hold in Block A.

Regulations Under The Mines and Minerals Act, 1962

The 1962 Act continued the regulations that were introduced shortly after the enactment of the 1949 Act.

Crown Reserve Natural Gas Licence Regulations

The Crown Reserve Natural Gas Licence Regulations under the 1962 Act were introduced on May 31, 1962.[34] Substantial differences existed between the regulations in force under the 1949 Act and the regulations in force under the 1962 Act. One should be aware that the 1962 regulations only applied to Crown Reserve natural gas licences granted on or after June 1, 1962.[35]

The Area That May Be Held Under Licence

The first important difference between the regulations was concerned with the area of a Crown Reserve that could be placed under a licence. Under the 1957 regulations the area of a licence was determined by the Minister who possessed the discretion to either approve or disapprove of an application for a specific area.[36] There was accordingly neither a strict limitation on the number of acres that could be held under a licence nor was there a limit on the number of licences that could be applied for by a single company. The 1962 regulations modified these provisions significantly. The maximum area that could be applied for by licence was 36 sections or 23,040 acres.[37] There was again no limitation on the number of licences that could be held by a single oil company.

The Lease Area

A second difference that is noted concerned the maximum area that could be held under a lease once the licence was surrendered. Under both the 1957 regulations and the 1962 regulations, the area that could be held under a lease was dictated by the depth of the well that produced the natural gas. For example, if a well were drilled to a depth not exceeding 3,000 feet and natural gas were discovered in commercial quantities, the area that could be acquired under a lease was six sections.[38] The difference between the regulations was that the 1962 regulations imposed a maximum on the number of acres that could be contained in a licence and thus indirectly limited the number of leases that could be obtained.

The drilling obligations, terms, fees, and rentals were the same under both the 1957 and 1962 regulations.

Natural Gas Licence Regulations

The Natural Gas Licence Regulations of 1962 affected licences granted on or after June 1, 1962.[39] The primary difference between the 1962 regulations and the regulations in force under the 1949 Act [40] concerned the area that could be held under a licence.

Area of a Licence

Under the regulations applicable to the 1949 Act, the maximum area of a licence was dictated by the size of the reservation. The 1962 regulations provided, however, that the maximum area of a licence was 36 sections.[41] A second difference between the two sets of regulations was that the 1949 regulations allowed a licencee to apply for a lease of ten sections if the well drilled reached a depth of 6,000 feet.[42] The 1962 regulations provided that at well depths exceeding 6,000 feet, ten sections could be applied for as well as an additional section for each 1,000 feet drilled in excess of 6,000 feet.[43]

Additional Terms

A licencee under both sets of regulations was required to drill a well within three months of the granting of the licence and another within ninety days of the completion or abandonment of the first.

If a natural gas lease was earned, the annual rental was 33 and 1/3 cents per acre, although this charge was able to be reduced to 10 cents per acre if an adequate market was not present.[44]

Petroleum and Natural Gas Reservation Regulations

The petroleum and natural gas reservation regulations under the 1962 Act [45] were substantially a reenactment of the regulations that were in force for reservations granted prior to 1962.[46] The principal change in the 1962 regulations was directed at the creation of Crown Reserves from the area of the reservation. Under the 1949 regulations, no lease was permitted nearer than one-half mile to the border of the reservation unless Crown Reserves of at least one mile in width had been established in lands adjoining the border.[47] The 1962 regulations modified this in that Crown Reserves now comprised "excepting at the boundary of a reservation, an area not less than one mile in width surrounding each location (lease)."[48]

The Reservation Area

The area which could be applied for as a reservation was limited to a maximum of 4 and 1/3 townships or 99,840 acres by the 1962 regulations.[49] A deposit of $2,5000 for each of 20,000 acres had to accompany the application for a reservation.

Exploration of the Reservation

A plan to conduct operations upon the reservation had to be prepared by the companies and approved by the Minister. The 1962 regulations allowed the holder of more than one reservation to combine the reservations, so long as the area did not exceed 200,000 acres under one plan.[50] The 1949 regulations required one plan for each reservation. Once the plan was approved the Minister, exploratory operations were carried out and generous renewal provisions were provided. The term of a reservation by these renewal provisions could be extended for a period of five years, with the initial period being included in this five year period.

What is of importance in assessing the above reservation regulations is that the Alberta government attempted to ease the burden of the oil companies. It was possible under the regulations for a company to hold a reservation and not drill a single well for a period of five years. This provided the oil companies with an opportunity to assess the market situation and choose either to drill or not depending upon the conclusion drawn.

Crown Reserve Drilling Regulations

The 1962 regulations [51] were a substantial reenactment of the 1949 regulations. The only change of major importance was that Crown Reserves in Block A were eliminated and withdrawn from the Crown Reserves Drilling Reservation Regulations.

Summary:

The second state in the relationship between Alberta and the oil companies developed during the period from 1949 to 1973. One notes a shift in bargaining power to the Alberta government during this period by reference to the increase in royalties payable to the Alberta government. This increase in royalties was made possible by the fact that the economic viability of the industry was assured and the investor-developers did not wish to abandon their profitable investments in the province. The governmental policy that prevailed however, was one of encouraging further development of oil and gas resources. The establishment of Block A was an example of this policy. Further support for this proposition is found by noting that the areas that could be held under a lease and a reservation were reduced. This provided the acreage which allowed other companies to participate in the development of oil and gas resources.

Footnotes Chapter 6

1. This point can be proved by noting that in 1947 capital expenditures in all mining activities including oil exploration, amounted to only 16 million dollars. By 1956 this figure was 187 million dollars. The increase in spending was directly attributable to the Leduc discovery which established the commercial viability of the industry. See E. Hanson, Dynamic Decade (1958) 251

2. S.A. 1949, c. 66

3. S.A. 1962, c. 49

4. Alta. Reg. 122/51

5. Alta. Reg. 129/57

6. Natural gas is found in various zones with a specific zone being determinted by the depth of the natural gas.

7. Alta. Reg. 542/49

8. Alta. Reg. 1705/52

9. *id.* at s. 3

10. *id.* at s. 22 (1). If petroleum were discovered while drilling for gas, the area that had to be surrendered to the Crown was equal to fifteen times the area applied to lease. Under the natural gas licence regulations, the area that had to be surrendered to the Crown was only equal to three times the area to be leased.

11. Alta. Reg. 581/54

12. Alta. Reg. 1026/37

13. Alta. Reg. 581/54

14. S.A. 1962, c. 49

15. *id.* at s. 125

16. S.A. 1949, c. 231 (2)

17. *supra* n. 14 at s. 114 (1)

18. *id.* at s. 114 (2)

19. A spacing unit for a petroleum well is usually 160 acres. A spacing unit for a natural gas well is usually one section or 640 acres.

20. S.A. 1962, c. 49, ss. 126 (1) (a) and (b)

21. id. at s. 127 and 128

22. id. at s. 129

23. id. at s. 130

24. Alta. Reg. 352/36

25. S.A. 1962, c. 49, s. 164 (3) (a). Section 167 allowed the Minister to postpone the drilling of a well under section 164 upon the payment of a penalty.

26. Under s. 247 of the 1949 Act there was a requirement that the lessee "commence drilling operations on the location within one year from the date of the lease." This requirement was rarely enforced owing to the surplus of crude oil that existed in Alberta during the 1950's and 1960's. The absence of a drilling requirement under the 1962 Act was an acknowledgement by the government of the market situation existing in this period.

27. S.A. 1962, c. 49, s. 124 (1)

28. id. at s. 124 (5)

29. Alta. Reg. 606/62

30. id. at s. 8

31. id. at s. 11

32. id. at s. 17

33. id. at s. 16

34. Alta. Reg. 807/62

35. id. at s. 3

36. Alta. Reg. 1373/57

37. Alta. Reg. 807/62, s. 7

38. id. at s. 15 (2) (a)

39. Alta. Reg. 776/62

40. Alta. Reg. 1297/57

41. Alta. Reg. 776/62, s. 6

42. Alta. Reg. 1297/57, s. 12 (2) (c)

43. Alta. Reg. 776/62, s. 17 (2)

44. Alta. Reg. 1297/57, ss. 17 (1) and (2) under the regulations pertaining to the 1949 Act and ss. 150 (1) and (2) of the 1962 Act.

45. Alta. Reg. 607/62

46. Alta. Reg. 2007/57

47. id. at s. 41 (a)

48. Alta. Reg. 607/62, s. 30 (a)

49. id. at s. 6

50. id. at s. 11 (6)

51. Alta. Reg. 722/62

Chapter 7

The Alberta Concession: 1973-1976

The third stage in the evolution of the relationship between Alberta and the oil companies operating there was reached in 1973 after the imposition of the Arab oil embargo. The Arab oil embargo greatly changed the relationship between Alberta and the oil companies because the embargo signified that energy had become a very valuable and very scarce commodity. Therefore Alberta was no longer constrained by overcapacity in its energy industry or an inadequate market for its engergy.[1] As a result, the position of the Alberta government vis-a-vis the oil companies was particularly strong.

The Mines and Minerals Amendment Act, 1973

The dominant position of the Alberta government vis-a-vis the oil companies was shown with the enactment of The Mines and Minerals Amendment Act, 1973.[2] Section 142.1 of the Act eliminated the maximum royalty payable under any lease granted by the Alberta government. This revision was primarily aimed at increasing governmental revenues owing to the increase in the price of crude oil brought about by the Arab oil embargo. It is interesting to note that this enactment was the first major change in oil and gas legislation in Alberta since The Mines and Minerals Act, 1962 was enacted.[3] Additional significant changes occurred in 1976 when additional amendments in the legislation were made.

The Mines and Minerals Amendment Act, 1976[4]

This Act was designed by the government to increase revenues and encourage further development of oil and gas resources in Alberta. The most important change made in the Act was the limiting of the duration of a petroleum and natural gas lease granted after July 1, 1976 to five years.[5] One should note that while the term of a petroleum and natural gas lease was reduced to five years, there was still no drilling obligation imposed upon the lessee. This term of five years was clearly designed, however, to encourage drilling and the production of oil, for at the expiration of the five year term of the lease, only the areas of the lease that were actually producing crude oil could be retained by the lessee.[6]

A second modification made under the1976 Act was that the Minister was able to auction off petroleum and natural gas leases.[7] Under the 1970 Act only drilling reservations and natural gas licences in Crown Reserves were auctioned off. The usual procedure under section 113 of the 1970 Act was to apply for a lease of petroleum and natural gas rights.

The 1976 Act also increased the petroleum and natural gas holdings of the Crown by reserving to the Crown petroelum and natural gas rights that were stratigraphically below the zone or zones granted under a lease.[8] This provision applied in the case of a lease granted under the 1976 Act at the expiration of the initial term of the lease and under leases granted before 1976 at the expiration of their initial terms or January 1, 1983, whichever was later.

Additional Changes in Oil and Gas Rights Brought About by the 1976 Act

The changes introduced by the 1976 Act to limit the rights which could be obtained from the Crown were significant. No petroleum and natural gas reservations were to be issued after June 30, 1976.[9] This increased the holdings of the government. Petroleum and natural gas permits were eliminated and none were to issue after June 30, 1976.[10] This again increased the holdings of the government. Petroleum and natural gas licences [11] were introduced, and natural gas licences [12] were retained, but the provisions relating to natural gas licences and leases derived therefrom were modified significantly.

Natural Gas Leases Under the 1976 Act

The Mines and Minerals Act, 1970 [13] allowed the Minister to reduce the rental per acre of a natural gas lease obtained from a natural gas licence from 33 and 1/3 cents to 10 cents per acre if inadequate markets for natural gas existed. The 1976 Act contained no such provision and the rental payment was required even if the natural gas could not be marketed. A further change of significance was that at the expiration of the 21 year term of a natural gas lease, [14] the area of the lease that was to continue henceforth was governed by the provisions of the statute relating to petroleum and natural gas leases. Therefore, only the area of the natural gas lease that was actually producing (i.e. the spacing unit) would be included in the new lease.[15]

Regulations Governing Petroleum and Natural Gas Leases

New regulations governing petroleum and natural gas leases were introduced on June 29, 1976.[16] These regulations modified the 1962 regulations in several respects.

The Drilling Requirement

Under the new regulations, drilling requirements were made applicable to ten year leases. Under The Mines and Minerals Act, 1962 no obligation was imposed upon the lessee to commence drilling operations during the ten year term of the lease, unless the lessee was served with a drilling notice. The effect of the 1976 regulations was to require the lessee to drill a well upon the leasehold before the end of the sixth year of the lease or incur a monetary penalty payable to the Minister.[17] This delay was only allowable during the term of a ten year lease and a penalty of $1 per acre the first year, $3 per acre the second year, and $5 per acre the third year was assessed.[18]

The Offset Well Requirement

A second modification introduced by the 1976 regulations was concerned with the offset well requirement. Under section 134 of the 1962 Act, a lessee was able to pay a compensatory royalty instead of drilling an offset well. The 1976 regulations retained this option but modified it by requiring that the fully royalty that would be payable if the freehold well were on Crown lands had to be paid after one year instead of as previously provided.[19]

Summary: Regulations Governing Oil and Gas Leases

The regulations indicate that the Alberta government was attempting to reduce the period during which a lessee who had obtained his lease prior to 1962 could delay the commencement of drilling. For ten year leases, the regulations have reduced this period to a minimum of six years before drilling had to begin.[20] The regulations also empowered the Minister to give notice to drill to holders of twenty-one year leases on the tenth anniversary date of the granting of these leases. Therefore with respect to pre-1976 leases, the maximum time that a lease could be held without conducting drilling operations was ten years. Post 1976 leases could be held for a period of five years without engaging in drilling activities.

Petroleum and Natural Gas Licence Regulations

Petroleum and natural gas licence regulations were introduced on

June 29, 1976 [21] and replaced the petroleum and natural gas reservation regulations. Pursuant to the regulations, a petroleum and natural gas licence was offered by public tender.[22] The offer for a licence had to be accompanied by a fee of $500 and a further sum of $1.00 per acre to pay the rental for the first year of the term of the licence.

The term of a licence was two years if the location was in the plains area, four years if the location was in the northern area, and five years if the licence was in the foothills area.[23] The maximum area of a licence was determined by its location and was 29 sections in the plains area, 32 sections in the northern area, and 36 sections in the foothills area.[24] As under the 1976 regulations governing petroleum and natural gas leases, lincences could be grouped but such a group was limited to two licences and the distance between the two licences to be grouped was to be two miles or less.[25] Drilling upon a licence satisfied the drilling requirement upon the other licence.[26]

If a licencee obtained a producing well he could apply for a lease, the area of which was to be determined by the depth of the well drilled. If the well depth reached 16,500 feet 29 secitons could be applied for in the plains area, 32 sections in the northern area, and 36 sections in the foothills area.[27] If the minimum depth of 500 feet was drilled, the figures were respectively, 3, 5, and 8 sections.

A licence pursuant to section 14 of the regulations could be extended for a period of sixty days if the well drilled was not completed or had been abandoned before the expiration of the term of the licence. The licencee would then have to complete the well or drill another one.

In addition, section 16 of the regulations provided that no rental was payable by a licencee if drilling operations were initiated in the first year and the area in which the drilling took place would likely be leased.

Summary

The most important conclusion one can draw in assessing this third stage in the relationship between the oil companies and Alberta is that the market constraints which previously existed have disappeared. This situation is directly traceable to the Arab oil embargo of 1973 and the resulting energy crisis. Alberta was no longer constrained by overcapacity and inadequate markets for its petroleum. As a result the position of the Alberta government vis-a-vis the oil companies was particularly strong.

This strong governmental position was shown by the statutes and regulations enacted in 1973 and 1976. The term of a petroleum and natural gas lease was shortened to five years, a bonus was payable upon the granting of a lease, and a drilling obligation was imposed upon the lessee if the term of the lease was to extend beyond a five year period. These obligations of the lessee were similar to thos imposed upon partners to joint-ventures in Iran.

Footnotes Chapter 7

1. Before the 1973 Arab oil embargo, the market situation faced by Alberta producers was not favourable. Most of eastern Canada relied upon imported oil. Alberta was forced to market the majority of its petroleum in the United States and faced tariffs to restrict the amount of oil which it could sell to that country.

2. S.A. 1973, c. 94

3. S.A. 1962, c. 49

4. S.A. 1976, c. 33

5. s. 118 (1)

6. s. 119

7. s. 112 (1) (a)

8. s. 123

9. s. 126 (3)

10. s. 127 (3)

11. s. 125

12. s. 128

13. S.A. 1970, c. 238

14. Under the 1970 Act, the term of a natural gas lease was 21 years and was renewable for further terms each of 21 years so long as natural gas was geing produced incommercial quantities. The 1976 Act modified this in that the term was reduced to 21 years.

15. s. 129 (a) (a)

16. Alta. Reg. 168/76

17. id. at s. 2

18. id. at s. 4

19. id. at s. 13 (2) (b)

20. id. at s. 2 (e)

21. Alta. Reg. 169/76

22. id. at s. 4 (1)

23. _id._ at s. 5
24. _id._ at s. 7
25. _id._ at s. 12
26. _id._ at s. 12 (3)
27. _id._ at Schedule B

Recent Developments in Alberta

After 1976, the development of oil and gas resources in Alberta continued at a rapid pace. Conventional drilling activities increased and the first synthetic crude oil plant began operations. In 1980 serious difficulties arose between the Ottawa and Alberta governments over their respective shares of oil and gas revenues from the companies operating in Alberta. Both levels of government sought additional revenues and the companies operating in Alberta were in a position to supply such revenue. The result of these difficulties has been an exodus of the smaller oil companies who refused to meet this demand.

The oil companies operating in Alberta are now in the same disadvantageous position as Alberta, when, much earlier, she began to grant concessions under The Provincial Lands Act. Now the companies can either accede to the demands of Ottawa, and perhaps Alberta, or cease their activities. The demand for petroleum is such that most major companies no longer have alternative sources of supply. Furthermore, there are many investor-developers willing and able to develop leases held by other companies in Alberta if these leases are surrendered to the Alberta government. The government of Alberta, owing to the Heritage Fund, is now in a position of fincancial strength whereby concessions to the oil companies need not be made.

Chapter 8

Conclusions

It was submitted in the first chapter of this thesis that the relationship between an owner of resources and an investor-developer typically undergoes an evolutionary development that is reflected in the types of contracts made between the parties. It was further submitted that this relationship can be divided into three separate stages. In the first stage of the relationship the investor-developer holds the balance of power owing to his financial, technical and marketing expertise. In the second stage of this relationship, the financial benefits derived by both parties suggest that each has an equal interest in the continuation of the concession. The owner derives its budget from the revenues and the investor-developer substantial profits. Neither party can prosper without the other. The third stage in the relationship is reached when the owner is in a position to exact maximum financial and political benefits from its resources. At this stage the investor-developer has to be grateful for whatever he receives.

In the case of Iran, this thesis was clearly made out. When the D'Arcy Concession was granted in 1901, Iran was not in a position, either politically or economically, to demand an advantageous contract from the concessionnaire. In fact, Iran received what the concessionnaire, D'Arcy, chose to give. As the concession developed and became the most profitable in the Middle East, Iran was able to exact certain benefits from the concessionnaire. This was shown by the provisions of both the 1933 Concession and the latter Consortium Agreement. Yet neither of the parties could exist without the other. On the one hand, Iran required the technical and marketing skills possessed by the concessionnaire who could still, although at some considerable loss, employ them elsewhere. The concessionnaire was unwilling to suffer such a loss. In 1973, the third stage in the relationship was reached and the Iranian Sales and Purchase Agreement resulted. This agreement gave Iran absolute control over its oil industry. The investor-developer became an offtaker and nothing more.

The evolution of the relationship between the owner and investor-developer in Alberta is perhaps less clear because it is much less dramatic. Nonetheless, it is submitted that in Alberta there were three distinct stages as well. The dividing lines between the stages are somewhat blurred because during much of the period under consideration, Alberta pursued two seemingly conflicting objectives: (1) the rapid development of its petroleum and natural gas resources and (2) the maximization of its profits. The former objective could be assured only by offering incentives to those willing to invest in development. Those incentives, as we have seen, often were financial in form. As a result, Alberta received relatively little from each investor-developer until 1962. Once this fact has been noted, however, it should not be allowed to obscure what seems, in retrospect, equally obvious. Alberta made something from each of a great number of investor-developers who, but for the financial incentives, might have chosen to invest elsewhere. Neither party could benefit economically until the marketing conditions changed in 1973. Thereafter, Alberta rapidly asserted her dominate position as owner of the resource.

In 1930 when Alberta obtained control over its natural resources, the oil companies operating in Alberta received highly favourable terms from the government. Such terms were granted because the economic viability of the oil industry was still in question. In 1949 the second stage in the relationship between Alberta and the investor-developers was reached when the Leduc discovery confirmed the importance of the oil and gas industry in Alberta. Both parties benefitted tremendously during this period but the Alberta government was unable to assert absolute control because the market situation prevented such a course of the action. The third stage in the relationship between Alberta and the investor-developers was reached in 1973 when the government was able to impose unilateral royalties. The difficult market situation had disappeared with the imposition of the Alberta oil embargo.

The types of contracts entered into between the oil companies and the respective governments indicate that the situation in the respective states was similar. In both Iran and Alberta the early concession contracts contained similar terms. The area, term, and financial benefits provided in the various contracts were similar. As the relationship between the various parties progressed, terms found in the Iranian contracts were later used by the Alberta government in their contracts. The requirement that natural gas be utilized is one such example.

The divergence that one finds in assessing the oil policies of the two states is the method chosen by each state to assert control over the oil companies. The Iranian government in 1951 chose to nationalize the concession without compensation. This course of action resulted in a British economic boycott and Amercian political involvement: The re sult of the boycott was thus great political and economic harm for Iran. Iran was not able to reassert such a degree of control again until 1973 when the market for petroleum changed following the Arab oil embargo.

Alberta, on the other hand, never relinquished her sovereignty to the oil companies and was never involved in a situation in which the stability of the government depended upon the goodwill of a foreign concessionnaire. Alberta made concessions to the oil companies only because the economic climate in the province required them. In 1931 when Alberta established regulations relating to the leasing of Crown oil and gas rights the economic viability of the industry was in question. In 1949, when the industry was firmly established, excessive governmental returns could not be made because of the market situation. Only in 1973 could the government ofAlberta actually assert itself and this was because of an oil embargo imposed by Middle Eastern producers.

SUPPLEMENT AGREEMENT BETWEEN THE IMPERIAL IRANIAN GOVERNMENT AND THE ANGLO-IRANIAN OIL COMPANY, LIMITED, MADE AT TEHRAN ON 17th JULY 1949

Whereas on the 29th April 1933, an Agreement (herein called "the Principal Agreement") was entered into between the Imperial Government of Persia (now known as "the Imperial Iranian Government") of the one part and the Anglo-Persian Oil Company, Limited") of the other part which established a Concession for the regulations of the relations between the two parties above mentioned.

And whereas the Government and the Company have after full and friendly discussion agreed that in view of the changes in economic conditions brought about by the World War of 1939-1945 the financial benefits accruing to the Government under the Principal Agreement should be increased to the extent and in the manner hereinafter appearing.

And whereas for this purpose the parties have agreed to enter into a Supplemental Agreement:

Now it is hereby agreed between the Imperial Government and the Anglo-Iranian Oil Company, Limited, as follows:

1. This Agreement is supplemental to and shall be read with the Principal Agreement:

2. Any of the terms used herein which have been defined in the Principal Agreement shall have the same meaning as in the Principal Agreement, save that, for the purposes of this Agreement, all references in the Principal Agreement to Persia, Persian, the Imperial Government of Persia and the Anglo-Persian Oil Company, Limited, shall be read as references to Iran, Iranian, the Imperial Iranian Government and the Anglo-Iranian Oil Company, Limited, respectively, and the references to the Permanent Court of International Justice shall be read as references to the International Court of Justice established by the United Nations.

3. (a) In respect of the calendar year ended 31st December 1948, and thereafter, the rate of the annual royalty payable to the Government under sub-clause (1) (a) of Article 10 of the Principal Agreement shall be increased from four shillings to six shillings per ton of petroleum sold for consumption in Iran or exported from Iran.

(b) The Company shall, within a period of thirty days from the date of coming into force of this Agreement, pay to the Government the sum of three million three hundred and sixty-four thousand four hundred and fifty-nine pounds sterling (3,304,459), as a retrospective application to cover the calendar year ended 31st December 1948, of the modification introduced by sub-clause (a) of this Clause 3, taking into account the provisions of sub-clause (V) (a) of Article 10 of the Principal Agreement.

4. (a) In order that the Government may recieve a greater and more certain and more immediate benefit in respect to amounts placed to the General Reserve of the Anglo-Iranian Oil Company, Limited, than that provided by sub-clause (I) (b) and sub-clause (III) (a) of Article 10 of the Principal Agreement, the Company shall pay to the Government in respect of each amount placed to the General Reserve of the Anglo-Iranian Oil Company, Limited, in respect of each financial period for which the accounts of that Company are made up (starting with the financial period ended 31st December 1948) a sum equal to twenty per cent (20%) of a figure to be arrived at by increasing the amount placed to General Reserve (as shown by the published accounts for the financial period in question) in the same proportion as twenty shillings sterling (s. 20/-) bear to the difference between twenty shillings sterling (s. 20/-) and the Standard Rate of British Income Tax in force at the relevant date.

The relevant date shall be the date of the final distribution to the ordinary stockholders in respect of the financial period in question, or, in the event of there being no such final distribution, a date one calendar month after the date of the annual general meeting at which the accounts in question were presented.

Examples of the implementation of the principle set out in this sub-clause (a) have been agreed between the parties hereto and are set out in the Schedule to this Agreement.

(b) If, in respect of any financial period for which the accounts of the Anglo-Iranian Oil Company, Limited, are made up (starting with the financial period ended 31st December 1948), the total amount payable by the Company to the Government under sub-clause (a) of this Clause 4 and sub-clause (I) (b) of Article 10 of the Principal Agreement shall be less than four million pounds sterling (4,000,000), the Company shall pay to the Government the difference between the said total amount and four million pounds sterling (4,000,000). Provided, however, that if during any such financial period the Company shall have ceased, owing to events outside its control to export petroleum from Iran, the amount payable by the Company in respect of such period in accordance with the foregoing provisions of this sub-clause (b) shall be reduced by a sum which bears to such financial period.

(c) Any sum due to the Government in respect of any financial period under sub-clause (a) or sub-clause (b) of this Clause 4 shall be paid on the relevant date appropriate to that financial period.

(d) The provisions of Clause (V) of Article 10 of the Principal Agreement shall not apply to any payments made by the Company to the Government in accordance with sub-clause (a) or sub-clause (b) of this Clause 4.

5. (a) In respect of the sum of fourteen million pounds sterling (14,000,000) shown in the Balance-heet of the Anglo-Iranian Oil Company, Limited, dated 31st December 1947, as constituting the General Reserve of that Company, the Company shall, within a period of thirty days from the date of coming into force of this Agreement, pay to the Government the sum of five million and ninety thousand nine hundred and nine pounds sterling (5,090,909).

(b) The provisions of Clause (V) of Article 10 of the Principal Agreement shall not apply to the payment to be made by the Company in accordance with sub-clause (a) of this Clause 5.

6. The payments to be made by the Company under Clauses 4 and 5 of this Agreement shall be in lieu of and in substitution for -

(i) any payments to the Government under sub-clause (I) (b) of Article 10 of the Principle Agreement in respect of any distribution relating to the General Reserve of the Company, and

(ii) any payment which might become payable by the Company to the Government in respect to the General Reserve under sub-clause (III) (a) of Article 10 of the Principal Agreement on the expiration of the Concession or in the case of surrender by the Company under Article 25 of the Principal Agreement.

7. (a) In respect of the calendar year ended 31st December 1948, and thereafter, the rate of payment to be made by the Company to the Government in Accordance with sub-clause (I) (c) of Article 11 of the Principal Agreement which relates to the payment to be made in respect of the excess over 6,000,000 tons shall be increased from ninepence to one shilling.

(b) The Company shall, within a period of thirty days from the date of coming into force of this Agreement, pay to the Government the sum of three hundred and twelve thousand nine hundred pounds sterling (312,900), as a retrospective application to cover the calendar year ended 31st December 1948, of the modification introduced by sub-clause (a) of this Clause 7, taking into account the provisions of sub-clause (V) of Article 10 of the Principal Agreement.

8. (a) At the end of sub-clause (a) of Article 19 of the Principal Agreement, there shall be added a paragraph in the following terms: "If at any time either party shall consider that either Roumanian prices or Gulf of Mexico prices no longer provide suitable standards for fixing 'basic prices', then the 'basic prices' shall be determined by mutual agreement of the parties, or in default of such agreement by arbitration under the provisions of Article 22. The 'basic prices' so determined shall become binding on both parties by an agreement effected by exchange of letters between the Government (which shall have full capacity to enter into such an agreement) and the Company."

(b) As from the 1st June 1949, the prices at which the Company shall sell motor spirit, kerosene and fuel oil, produced from Iranian petroleum to consumers other than the Government for internal consumption in Iran, shall be the basic prices with a deduction of twenty-five per cent (25%), instead of a deduction of ten per cent (10%) as provided in sub-clause (b) of Article 19 of the Principal Agreement.

9. In consideration of the payment of the above sums by the Company, the Government and the Company agree that all their obligations one to another accrued up to the 31st December 1948, in respect of sub-clause I (a) and sub-clause (I) (b) of Article 10 and in respect of Article II of the Principal Agreement and also in respect of the General Reserve have been fully discharged.

10. Subject to the provisions of this Agreement, the provisions of the Principal Agreement shall remain in full force and effect.

11. This Agreement shall come into force after ratification by the Majlis and on the date of its promulgation by Decree of His Imperial Majesty the Shah. The Government undertakes to submit this Agreement, as soon as possible, for ratification by the Majlis.

Examples of the Implementation of the Principle set out in Sub-clause (a) of Clause 4 of the within Agreement on the Assumption that 1,000,000 is Placed to General Reserve

	EXAMPLE I	EXAMPLE II	EXAMPLE III
1. Standard Rate of British Income Tax	10s. in the 1	9s. in the 1	5s. in the 1
2. Amount placed to General Reserve as shown by the published accounts for the financial period in question	1,000,000	1,000,000	1,000,000

3. The above amount is increased as follows:

A Twenty Shillings Sterling	Standard Rate of British Income Tax	B Difference	Proportionate Increase A	B	EXAMPLE I	EXAMPLE II	EXAMPLE III
20s.	10s.	10s.	20	10	2,000,000		
20s.	9s.	11s.	20	11	-	1,818,182	
20s.	5s.	15s.	20	15	-	-	1,333,333

	EXAMPLE I	EXAMPLE II	EXAMPLE III
4. The "sum equal to 20%" which is therefore payable to the Iranian Government is	400,000	363,636	266,667

Made at Tehran the 17th July, one thousand nine hundred and forty nine

For the Imperial Iranian Government:
(*sgd.*) A.Q. GULSHAYAN.

For and on behalf of the Anglo-
Iranian Oil Company, Limited:

(*Sgd.*) N.A. GASS.

AGREEMENT CONCLUDED ON 22nd DECEMBER 1920 BETWEEN THE ANGLO-PERSIAN OIL COMPANY, LIMITED AND SYDNEY ARMITAGE ARMITAGE-SMITH, ESQ., C.B., AS REPRESENTATIVE OF THE IMPERIAL PERSIAN GOVERNMENT

Agreement dated December 22nd one thousand nine hundred and twenty between the Imperial Persian Government and the Anglo-Persian Oil Company, Limited, with respect to determining the manner in which the annual sum or royalty payable to the Persian Government under the D'Arcy Concession dated in May one thousand nine hundred and one shall as from the thirty-first March one thousand nine hundred and nineteen be ascertained.

Definitions

In this Agreement, unless the context otherwise requires, "Persian Oil" shall be deemed to mean oil won pursuant to the said concession within the territory of the Persian Empire covered by the concession and any product of such oil.

"The Government" means the Imperial Persian Government.

"The Company" means the Anglo-Persian Oil Company, Limited.

"Subsidiary Company" shall be deemend to mean (a) any company of which "the Company" owns whether directly or through some other subsidiary company a number of shares sufficient to give to "the Company" the control of more than fifty per cent of the total votes which can be cast at a general meeting of shareholders of such company; (b) any company more than one-half of the directors or which are nominated or appointed by "the Company" and/or by any subsidiary company and in addition in the case of shipping companies; (c) any company which is managed by "the Company"; "a controlling interest" is the interest of "the Company" is a subsidiary company.

Article I. - Subject to the conditions, limitations and exceptions hereinafter mentioned, the Imperial Persian Government (hereinafter referred to as "the Government") is entitled to receive from the Anglo-Persian Oil Company, Limited (hereinafter referred to as "the Company"), the royalty of sixteen per cent of all the annual net profits arising from the winning, refining and marketing of Persian oil, whether all the stages of the above processes be handled by the Company itself or through subsidiary companies or by means of pooling schemes or other arrangements, and whether the refining and marketing takes place within the Persian Empire or not, subject always to the single exception that the Government is not to receive royalty on the profits arising from the transportation of oil by means of ships, but subject to the conditions and limitations hereafter mentioned, the profits however arising from the employment of lighters and other small craft in the Persian Gulf will be subject to the above-mentioned royalty.

Article 2. - In ascertaining the net profits arising from Persian oil, freight costs will, when the oil is carried in tankers of "the Company" or of any subsidiary company, be based upon the ordinary market time charter rates for tankers similar to those employed in carrying the oil irrespective of the freights actually paid, such time charter rates to be fixed year by year on the first day of April for the ensuing twelve months at the rate current on that date.

For the purpose of computing such freight costs, voyage rates shall be charged based on the time charter rates and full account shall be taken of all other freight earned by the ships during the voyage in question. If at any time during the months of January, February and March in any year either of the parties hereto shall give notice in writing to the other that in the opinion of that party there is no free market in time charters for oil tankers, then, failing agreement between the parties that question and if it be decided in the affarmative also the question of what will be a fair and proper rate of freight to be charged as from the first of April next following the giving of such notice against Persian oil for the purposes of this Agreement shall be submitted to a single arbitrator whose decision shall be final. Such arbitrator shall, in default of agreement between the parties, be nominated by the President for the time being of the Chamber of Shipping in London. As regards the royalty accounts for the years ending thirty-first March one thousand nine hundred and twenty and thirty-first March one thousand nine hundred and twenty-one, the parties will as soon as possible after signature of this Agreement agree rates or failing agreement within three months of the date hereof, rates shall be settled by an arbitrator as above provided.

Article 3. - The provisions of this and the next following Article of this Agreement shall apply to subsidiary companies refining, distributing or dealing with Persian oil outside Persia, and to any other company refining, distributing or dealing with Persian oil outside Persia where "the Company" is able to procure the necessary accounts to be prepared by such company and the necessary facilities for inspection to be given by such company to the Government. In the case of any company to which this clause applies, the following deductions shall be made from the net profits ascertained as hereafter provided on which royalty is to be calculated before computing the amount of the royalty, viz.:

(a) In the case of refining companies:

A deduction of six shillings per ton in respect of the first three-quarters of a million tons throughput of Persion oil per annum, a deduction of five shillings and sixpence per ton on all throughput of Persian oil between three-quarters of a million tons and one million tons per annum, and a deduction of five shillings per ton on all throughput of Persian oil in excess of one million tons per annum.

(b) In the case of distributing companies:

Qualities	*Quantities of Persian oil distributed by a single company in any year*		*Rate of deduction per gallon, per pound, or per ton of Persian oil*
	Tons		
Kerosene	150,000		$\frac{5}{8}$d. per gallon
Spirit	200,000		1d. "
Liquid fuel	300,000		$\frac{1}{2}$d. "
Gas oil	25,000		$\frac{1}{2}$d. "
Lubricants and all other oils not otherwise specified	20,000		Id. "
Wax and candles . . .	4,000		$\frac{1}{8}$d. Per lb.
Pitch	50,000	2s.	6d. Per ton
Medicinal oils	100		6d. per gallon

In the event of the quantities of any quality distributed by any company exceeding the quantities above stated by not more than fifty per cent, then the rate of deduction on such excess for that quality shall be reduced by one-eighth, and, in the event of the quantities of any quality distributed by any of the companies exceed-the above quantities by more than fifty per cent, then the rate of deduction on such excess over fifty per cent for that quality shall be reduced by one-quarter.

(c) The above deductions shall be made from the total net profits of any company arising from Persial oil before calculating the royalty, and if such deductions more than absorb the whole of the profit then any deficiency so caused shall not be carried forward to any subsequent year and any such deficiency in the case of one company shall not be set against the net profit in the case of any other company. PROVIDED ALWAYS that such deductions shall only be made once for refining in respect of any quantity of oil and once for marketing, distributing or dealing with and "quality."

Article 4. - In cases where a refining or distributing company to which this Article applies handles other oil or oil products in addition to Persian oil, the net profits on Persian oil on which royalty is to be paid shall be ascertained each year as follows:

(a) In the case of refining companies:

I. When the refining company does not buy the oil but refines the oil for payment, then the cost of refining Persian oil (including a proper proportion of overhead charges other than those which are not chargeable under this Agreement) shall be ascertained as nearly as possible from the books of the refining company, and the net profits attributable to Persian oil shall be obtained by deducting such cost from the charges made for refining such oil.

2. When the refining company purchases the oil, then the actual price paid by the refining company for the Persian oil refined during the year shall be ascertained from the books.

The cost of refining the Persian oil (including such overhead charges as aforesaid) will be ascertained as nearly as possible from the books and added to the said price, and the total will be deducted from the selling value of the products of such refining, the balance being the profit or loss on Persian oil; for the purpose of ascertaining the selling value of the refined products from Persian oil the total quantities of the refined products from Persian and other oils shall be allocated between Persian and other oil on the basis of the respective outputs from the respective crude oils if refined separately. If Persian and other crude oils are mixed for refining purposes, then the allocation shall be made on the basis of the quantities of each class so refined, and the respective qualities as determined by chemical analysis. The selling value of refined products sold during the year shall be taken at the prices realized. Refined products not sold during the year shall be taken at the prices subsequently realized.

(b) In the case of distributing companies:

The prices realized for Persian and other oil products distributed during any year shall be kept separately, and there shall be deducted therefrom in each case the price paid for such products by the distributing company in order to arrive at the respective gross profits on Persian and other oils.

The total net profit of the distributing company for the distribution of all classes of oil during the year shall be ascertained as hereinafter provided (Article 7), and shall be apportioned between Persian and other oil in proportion to the respective gross profits ascertained as aforesaid.

In cases where a company both refines and distributes oil, the accounts of such company for the purposes of this Agreement shall be made out as if the two branches of the business were carried on by separate companies.

"The Company" shall keep and shall procure that all companies to which this and the preceding clause apply shall keep proper books of account and other records to enable the necessary calculations of costs and profits to be made for the purposes of this Agreement.

Article 5. - (a) In the case of any subsidiary company in which the Company holds the whole of the share capital, the total net profits arising from Persian oil (arrived at in accordance with this Agreement) shall be included in the royalty statement, subject to and showing the deductions provided for in Clause 3. In the case of any other subsidiary company or of any other company to which the provisions of Articles 3 and 4 apply, the net profits arising from Persian oil shall be determined in accordance with this Agreement, but the Government shall only be entitled in respect of any year to royalty on a proportion of the net profits from Persian oil for such year after making the deductions provided for in Clause 3, bearing the same relation to the whole of such profits as the proportion of the whole profits of such company for such year which "the Company" would receive in respect of its shareholding or otherwise if the whole profits were distributed bears to the whole of such profits. If "the Company's" interest in any company has been increased or diminished during any year, then an allowance shall be made in respect thereof, having regard to all material circumstances.

(b) In the case of companies in which "the Company" is interested but to which Articles 3 and 4 do not apply, "the Company" shall include in the statement of net profits on which royalty is to be calculated a fair commercial profit in respect of all Persian oil sold to any such other company, having regard to the period of the contract the quantities and qualtities of oil to be supplied and all other terms of any material agreement. Any difference as to what is a fair commercial profit shall be referred to arbitration as hereafter provided.

Article 6. - All directors' fees and office charges of "the Company" shall be allocated fairly as between "the Company" and all subsidiary companies as may be agreed by the parties or as may be settled by arbitration.

Article 7. - The net profits of "the Company" and of subsidiary companies or other companies to which Articles 3 and 4 hereof apply shall be taken for the purposes of this Agreement to be the net profits for each year as adjusted for income tax purposes, subject to the following conditions, viz:

(i) Any adjustments made in respect of any period prior to thirty-first March one thousand nine hundred and nineteen shall be excluded.

(ii) Depreciation shall only be allowed to the extent to which it may be allowed for income tax purposes and shall not include any sum in respect of depreciation carried forward from any period prior to thirty-first March one thousand nine hundred and nineteen.

(iii) No deduction shall be made in respect of excess profits, duty corporation profits tax, income tax or any other taxation of a similar nature imposed by the British Government or by any Colonial or Foreign Government (other than the Persian Government).

(iv) No deductions shall be made from the profits for interest or dividends of any description paid, and interest and dividends received shall be excluded from the profits on which royalty is payable.

(v) Where for the purposes of this Agreement it is necessary to determine the profits of any company which is not liable to British taxation, the profits of that company shall be determined as nearly as may be in the same manner as they would be if the company were liable to British income tax.

(vi) No deduction shall be allowed in respect of royalty payable under this Agreement by "the Company" or any subsidiary company, and no deduction shall be allowed in respect of payments relating to dividends guaranteed by the Company, except in so far as such dividends are themselves brought into account as part of the receipts of some other company on which royalty is calculated.

(vii) No deduction shall be made in respect of the annual value of lands and buildings owned and occupied under Schedule A.

(viii) The net profits and losses for each year ascertained as aforesaid (and subject to the provisions relating to deductions referred to Article 3) shall be aggregated and royalty shall be payable, on the balance (if any) of profit after deducting the losses, but if in any year the aggregate losses exceed the aggregate profits, the excess shall not be carried forward to a subsequent year, except to the extent that such loss is due to depreciation allowed under sub-clause (ii) of this clause.

Article 8. - Royalty shall be deemed to have accrued due on thirty-first March each year in respect of the twelve months ending on that day, but such royalty shall not become payable until the date of the holding of the general meeting of "the Company" for passing the accounts for such year. The royalty shall carry interest at the rate of six per cent per annum free of tax from thirty-first March on which to accrued due until payment; "the Company" will endeavour to secure that the accounts of all subsidiary and other companies to which Articles 3 and 4 apply shall be made up to the thirty-first March in each year, but if in any cases this is not found practicable, then, for the purposes of this Agreement the net profits of such company for its financial year last preceding the thirty-first March shall be substituted for the net profits to the thirty-first March, and any necessary adjustment shall be made.

Article 9. - A statement of the royalty payable shall be prepared by "the Company" each year and shall be submitted to a person to be designated in that behalf by the Government fourteen days before the date of the holding of the annual meeting of the Company. Such statement shall be deemed to be correct except as regards any items challenged by the Government within six calendar months of the delivery of the statement or any supplemental statement delivered in explanation or amplification thereof.

If the statement of royalty is in the opinion of the nominee of the Government not sufficient to enable him to judge whether the terms of the Concession and of this Agreement have been fulfilled, then the Company undertakes to give the nominee of the Government access to all information which he may reasonably require for that purpose.

In the event of any dispute arising in connection with the said statement or the calculation of royalty here under or as to any apportionment or adjustment to be made hereunder or otherwise arising out of or under this Agreement, the question or questions in dispute shall be submitted to a chartered accountant to be nominated by the President for the time being of the Institute of Chartered Accountants in England, who shall be empowered to decide the dispute having regard to the terms of the Concession and of this Agreement and to the generally accepted view of what constitutes "nett profits" where a percentage thereof is payable to another party. The decision of such arbitrator shall be final.

Article 10. - The Government undertakes to use it best endeavours to facilitate the work of "the Company" and its subsidiary companies, and the Company agrees that it will not enter into any fictitious or artificial transaction which would have the effect of reducing the amount of royalty payable.

As Witness the hands of the respective duly authorized representatives of the Government and the Company the day and year first above written.

Signed by Sydney Armitage Armitage-Smith, the Financial Advisor to the Imperial Persian Government for and on behalf of the Imperial Persian Government in the presence of

(Sgd.) WILLIAM MCLINTOCK,
Chartered Accountant,
Bond Court House
Walbrook, London

(Sgd.) SYDNEY ARMITAGE
ARMITAGE-SMITH

Signed by
for and on behalf of the
Anglo-Persian Oil Company,
Limited, in the presence of

(Sgd.) FRED G. WATSON,
23, Gt. Wichester St.,
London, E.C.2,
Solicitor.

For and on behalf of the
Anglo-Persian Oil Company,
Limited.

(Sgd.) C. GREENWAY,
Chairman.
F. MACINDOE,
Secretary.

DEFINITIONS

The following definitions of certain terms used in the present Agreement are applicable for the purposes hereof without regard to any different meaning which may or might be attributed to those terms of other purposes.

"The Government"

means the Imperial Government of Persia.

"The Company"

means the Anglo-Persian Oil Company, Limited and all its *subordinate companies*.

"Subordinate Company"

means any company for with *the Company* has the right to nominate directly or indirectly more than one-half of the directors, or in which *the Company* holds, directly or indirectly, a number of shares sufficient to assure it more than 50% of all voting rights at the general meetings of such a company.

"Petroleum"

means crude oil, natural gases, asphalt, ozokerite, as well as all products obtained either from these substances or by mixing these substances with other substances.

"Operations of the Company in Persia"

means all industrial, commercial and technical operations carried on by *the Company* exclusively for the purposes of this Concession.

ARTICLE I

The Government grants to *the Company*, on the terms of this Concession, the exclusive right, within the territory of the Concession, to search for and extract *petroleum* as well as to refine or treat in any other manner and render suitable for commerce the *petroleum* obtained by it.

The Government also grants to *the Company*, throughout Persia, the non-exclusive right to transport *petroleum*, to refine or treat it in any other manner and to render it suitable for commerce, as well as to sell it in Persia and to export it.

ARTICLE 2

(A) The territory of the Concession, until 31st December 1938, shall be the territory to the south of the voilet line* drawn on the map signed by both parties and annexed to the present Agreement.

(B) *The Company* is bound, at latest by 31st December 1938, to select on the territory above mentioned one or several areas of such shape and such size and so situated as *the Company* may deem suitable. The total area of the area or areas selected must not exceed one hundred thousand English square miles (100,000 square miles), each linear mile being equivalent to 1,609 meters.

The Company shall notify to *the Government* in writing on 31st December 1938, or before that date, the area or areas which it shall have selected as above provided. The maps and data necessary to identify and define the area or areas which *the Company* shall have selected shall be attached to each notification.

(C) After 31st December 1938, *the Company* shall no longer have the right to search for and extract *petroleum* except on the area or areas selected by it under paragraph (B) above, and the territory of the Concession, after that date, shall mean only the area or areas so selected and the selection of which shall have been notified to *the Government* as above provided.

ARTICLE 3

The Company shall have the non-exclusive right to construct and to own pipelines. *The Company* may determine the position of its pipelines and operate them.

ARTICLE 4

(A) Any unutilized lands belonging to *the Government*, which the company shall deem necessary for its *operations in Persia* and which *the Government* shall not require for purposes of public utility, shall be handed over gratuitously to *the Company*.

The manner of acquiring such lands shall be the following: whenever any land becomes necessary to *the Company*, it is bound to send to the Ministry of Finance a map or maps on which the land which *the Company* needs shall be shown in colour. *The Government* undertakes, if it has no objection to make, to give its approval within a period of three months after receipt of *the Company's* request.

(B) Lands belonging to *the Government*, of which use is being made, and which *the Company* shall need, shall be requested of *the Government* in the manner prescribed in the preceding paragraph, and *the Government*, in case it should not itself need these lands and should have no objection to make, shall give, within a period of three months, its approval to the sale asked for by *the Company*.

The price of these lands shall be paid by *the Company;* such price must be reasonable and not exceed the current price of lands of the same kind and utilized in the same manner in the district.

(C) In the absence of a reply from *the Government* to request under paragraphs (A) and (B) above, after the expiry of two months from the date of receipt of the said request, a reminder shall be sent by *the Company* to *the Government;* should *the Government* fail to reply to such reminder within a period of one month, its slience shall be regarded as approval.

(D) Lands which do not belong to *the Government* and which are necessary to *the Company* shall be acquired by *the Company*, by agreement with the parties interested, and through the medium of *the Government*.

In case agreement should not be reached as to the prices, *the Government* shall not allow the owners of such lands to demand a price higher than the prices commonly current for neighbouring lands of the same nature. In valuing such lands, no regard shall be paid to the use to which *the Company* may wish to put them.

(E) Holy places and historical monuments, as well as all places and sites historical interest, are excluded from the foregoing provisions, as well as their immediate surroundings for a distance of at least 200 meters.

(F) *The Company* has the non-exclusive right to take within the territory of the Concession, but not elsewhere, on any unutilized land belonging to the State, and to utilize gratuitously for all the operations of the Company, any kinds of soil, sand, lime, gypsum, stone and other building materials. It is understood that if the utilization of the said materials were prejudicial to any rights whatever of third parties, *the Company* should indemnify those whose rights were infringed.

ARTICLE 2

(A) The territory of the Concession, until 31st December 1938, shall be the territory to the south of the voilet line* drawn on the map signed by both parties and annexed to the present Agreement.

(B) *The Company* is bound, at latest by 31st December 1938, to select on the territory above mentioned one or several areas of such shape and such size and so situated as *the Company* may deem suitable. The total area of the area or areas selected must not exceed one hundred thousand English square miles (100,000 square miles), each linear mile being equivalent to 1,609 meters.

The Company shall notify to *the Government* in writing on 31st December 1938, or before that date, the area or areas which it shall have selected as above provided. The maps and data necessary to identify and define the area or areas which *the Company* shall have selected shall be attached to each notification.

(C) After 31st December 1938, *the Company* shall no longer have the right to search for and extract *petroleum* except on the area or areas selected by it under paragraph (B) above, and the territory of the Concession, after that date, shall mean only the area or areas so selected and the selection of which shall have been notified to *the Government* as above provided.

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(A) Any unutilized lands belonging to *the Government*, which the company shall deem necessary for its *operations in Persia* and which *the Government* shall not require for purposes of public utility, shall be handed over gratuitously to *the Company*.

The manner of acquiring such lands shall be the following: whenever any land becomes necessary to *the Company*, it is bound to send to the Ministry of Finance a map or maps on which the land which *the Company* needs shall be shown in colour. *The Government* undertakes, if it has no

ARTICLE 5

The *operations of the Company in Persia* shall be restricted in the following manner:

(1) The construction of any new railway line and of any new port shall be subject to a previous agrement between *the Government* and *the Company.*

(2) If *the Company* wishes to increase its existing service of telephones, telegraphs, wireless and aviation in Persia, it shall only be able so to do with the previous consent of *the Government.*

If *the Government* is authorized to utilize the means of transport and communication of *the Company* for national defence or in other critical circumstances, it undertakes to impede as little as possible the operations of the Company, and to pay it fair compensation for all damages caused by the utilization above mentioned.

ARTICLE 6

(A) *The Company* is authorized to effect, without special licence, all imports necessary for the exclusive needs of its employees on payment of the custom duties and other duties and taxes in force at the time of importation.

The Company shall take the necessary measures to prevent the sale or the handing over of products imported to persons not employed by *the Company.*

(B) *The Company* shall have the right to import, without special licence, the equipment, material, medical and surgical instruments and pharmaceutical products, necessary for its dispensaries and hospitals in Persia, and shall be exempt in respect thereof from any custom duties and other duties and taxes in force at the time of importation, or payments of any nature whatever to the Persian State or to local authorities.

(C) *The Company* shall have the right to import, without any licence and exempt from any custom duties and form any taxes or payments of any nature whatever to the Persian State or to local authorities anything necessary exclusively for the *operations of the Company in Persia.*

(D) The exports of *petroleum* shall enjoy customs immunity and shall be exempt from any taxes or payments of any nature whatever to the Persian State or to local authorities.

ARTICLE 7

(A) *The Company* and its employees shall enjoy the legal protection of *the Government.*

(B) *The Government* shall give, within the limits of the laws and regulations of the country, all possible facilities for the *operations of the Company in Persia.*

(C) If *the Government* grants concessions to third parties for the purpose of exploiting other mines within the territory of the concession, it must cause the necessary precautions to be taken in order that these exploitations do not cause any damage to the installations and works of *the Company.*

(D) *The Company* shall be responsible for the determination of dangerous zones for the construction of habitations, shops and other buildings, in order that *the Government* may prevent the inhabitants from settling there.

ARTICLE 8

The Company shall not be bound to convert into Persian currency any part whatsoever of its funds, in particular any proceeds of the sale of its export from Persia.

ARTICLE 9

The Company shall immediately make its arrangements to proceed with its operations in the province of Kermanshah through a subsidiary company with a veiw of producing and refining *petroleum* there.

ARTICLE 10

(I) The sum to be paid to *the Government* by *the Company* in accordance with this Agreement (besides those provided in other articles) are fixed as follows:

(a) An annual royalty, beinning on the 1st January 1933, of four shillings per ton of *petroleum* sold for consumption in Persia or exported from Persia;

(b) Payment of a sum equal to twenty per cent (20%) of the distribution to the ordinary stockholders of *the Anglo-Persian Oil Company, Limited,* in excess of the sum of six hundred and seventy-one thousand two hundred and fifty pounds sterling (671,250), whether that distribution be made as dividends for any one year or whether it relates to the reserves of that Company exceeding the reserves which, according to its books existed on 31st. December 1932;

(c) The total amount to be paid by *the Company* for each calendar (Christian) year under sub-clauses (a) and (b) shall never be less than seven hundred and fifty thousand pounds sterling (750,000).

(II) Payments by *the Company* under this Article shall be made as follows:

(a) On 31st March, 30th June, 30th September and 31st December of each year, on each occasion one hundred and eighty-seven thousand five hundred pounds sterling (187,500). (The payment relating to 31st March 1933 shall be made immediately after the ratification of the present Agreement).

(b) On 28th February 1934, and thereafter on the same date in each year, the amount of the tonnage royalty for the previous year provided for in sub-clause (I) (a) less the sum of seven hundred and fifty thousand pounds sterling (750,000), already paid under sub-clause (II) (a).

(c) Any sums due to *the Government* under sub-clause (I) (b) of this Article shall be paid simultaneously with any distributions to the ordinary stockholders.

(III) On the expiration of this Concession, as well as in the case of surrender by *the Company* under Article 25 *the Company* shall pay to *the Government* a sum equal to twenty per cent (20%) of:

(a) the surplus difference between the amount of the reserves (General Reserve) of *the Anglo-Persian Oil Company, Limited*, at the date of the expiration of the Concession or of its surrender, and the amount of the same reserves at 31st December 1932;

(b) the surplus difference between the balance carried forward by *the Anglo-Persian Oil Company, Limited*, at the date of the expiration of the Concession or of its surrender and the balance carried forward by that Company at 31st December 1932. Any payment due to *the Government* under this clause shall be made within a period of one month from the date of the General Meeting of the Company following the expiration or surrender of the Concession.

(IV) *The Government* shall have the right to check the returns relating to sub-clause (I) (a) which shall be made to it at latest on 28th February for the preceding year.

(V) To secure *the Government* against any loss which might result from fluctuations in the value of English currency, the parties have agreed as follows:

(a) If, at any time, the price of gold in London exceeds six pounds sterling per ounce (ounce troy), the payments to be made by *the Company* in accordance with the present Agreement (with the exception of sums due to *the Government* under sub-clause (I) (b) and clause (III) (a) and (b) of this Article and sub-clause (I) (a) of Article 23) shall be increased by one thousand four hundred and fortieth part
(1) for each penny of increase of the price of
(1400)
gold above six pounds sterling (6) per ounce (ounce troy) on the due date of the payments.

(b) If, at any time, *the Government* considers that gold has ceased to be the general basis of values and that the payments above mentioned no longer give it the security which is intended by the parties, the parties shall come to an agreement as to a modification of the nature of the security above mentioned or, in defaulf of such an arrangement, shall submit the question to the Arbitration Court (Article 22) which shall decide whether the security provided in sub-clause (a) above ought to be altered and, if so, shall settle the provisions to be substituted therefor and shall fix the period to which such provisions shall apply.

(VI) In case of a delay, beyond the dates fixed in the present Agreement, which might be made by *the Company* in payment for sums due by it to *the Government*, interest at five per cent (5%) per annum shall be paid for the period of delay.

ARTICLE 11

(I) *The Company* shall be completely exempt, for its *operations in Persia*, for the first thirty years, from any taxation present or future of the State and of local authorities; in consideration therefor the following payments shall be made to *the Government:*

(a) During the first fifteen years of this Concession, on 28th February of each year and for the first time on 28th February 1932, nine pence for each of the first six million (6,000,000) tons of *petroleum*, on which the royalty provided for in Article 10 (1) (a) is payable for the preceding calandar (Christian) year, and six pence for each ton in excess of the figure of six million (6,000,000) tons above defined.

(b) *The Company* guarantees that the amount paid under the preceding sub-clause shall never be less than two hundred and twenty-five thousand pounds sterling (225,000).

(c) During the fifteen years following, one shilling for each of the first six million (6,000,000) tons of *petroleum*, on which the royalty provided for in Article 10 (I) (a) is payable for the preceding calendar year, and nine pence for each ton in excess of the figure of 6,000,000 tons above defined.

(II) Before the year 1963, the parties shall come to an agreement as to the amounts of the annual payments to be made, in consideration of the complete exemption of *the Company* for its *operations in Persia* from any taxation of the State and of local authorities, during the second period of thirty years extending until 31st December 1933.

ARTICLE 12

(A) *The Company*, for its *operations in Persia* in accordance with the present Agreement, shall employ all means customary and proper, to ensure economy in and good returns from its operations, to preserve the deposits of *petroluem* and to exploit its Concession by methods in accordance with the latest scientific progress.

(B) If, within the territory of the Concession, there exist other mineral substances than *petroleum* or wood and forests belonging to *the Government*, *the Company* may not exploit them in accordance with the present Concession, nor object to their exploitation by other persons (subject to the due compliance with the terms of clause (C) of Article 7); but *the Company* shall have the right to utilize the said substances or the woods and forests above mentioned if they are necessary for the exploitation or the extraction of *petroleum*.

(C) All boreholes which, not having resulted in the discovery of *petroleum*, produce water or precious substances, shall be reserved for *the Government*, which shall immediately be informed of these discoveries by *the Company*, and *the Government* shall inform *the Company* as soon as possible if it wishes to take possession of them. If it wishes to take possession, it shall watch that the operations of the Company be not impeded.

ARTICLE 13

The Company undertakes to send, at its own expense and within a reasonable time, to the Ministry of Finance, whenever the representative of *the Government* shall request it, accurate copies of all plans, maps, sections and any other data, whether topographical, geological or of drilling relating to the territory of the Concession, which are in its possession.

Furthermore, *the Company* shall communicate to *the Government* throughout the duration of the Concession all important scientific and technical data resulting from its work in Persia.

All these documents shall be considered by *the Government* as confidential.

ARTICLE 15

(A) *The Government* shall have the right to cause to be inspected at its wish, at any reasonable time, the technical activity of *the Company* in Persia, and to nominate for this purpose technical specialist experts.

(B) *The Company* shall place at the disposal of the specialist experts nominated to this end by *the Government*, the whole of its records relative means of measurement, and these specialist experts shall, further, have the right to ask for any information in all the offices of *the Company* and on all the territories in Persia.

ARTICLE 15

The Government shall have the right to appoint a Representative who shall be designated "Delegate of the Imperial Government". This Representative shall have the right:

(I) to obtain from *the Company* all the information to which the stockholders of *the Company* are entitled;

(2) to be present at all the meetings of the Board of Directors, of its committees and at all the meetings of stockholders, which have been convened to consider any question arising out of the relations between *the Government* and *the Company;*

(3) to preside *ex officio*, with a casting vote, over the committee to be set up by *the Company* for the purpose of distributing the grant for and supervising the professional education in Great Britain of Persian nationals referred to in Article 16;

(4) to request that special meetings of the Board of Directors be convened at any time, to consider any proposal that *the Government* shall submit to it. These meetings shall be convened within 15 days from the date of the receipt by the Secretary of *the Company* of a request in writing to that end.

The Company shall pay to *the Government* to cover the expenses to be borne by it in respect of the salary and expenses of the above-mentioned Delegate a yearly sum of two thousand pounds sterling (2,000). *The Government* shall notify *the Company* in writing of the appointment of this Deligate and of any changes in such appointment.

ARTICLE 16

(I) Both parties recognize and accept as the principle governing the performance of this Agreement the supreme necessity, in their mutual interest, of maintaining the highest degree of efficienty and of economy in the administration and the *operations of the Company in Persia.*

(II) It is, however, understood that *the Company* shall recruit its artisans as well as its technical and commercial staff from among Persian nationals, to the extent that it shall find in Persia persons who possess the requisite competence and experience. It is likewise understood that the unskilled staff shall be composed exclusively of Persian nationals.

(III) The parties declare themselves in agreement to study and prepare a general plan of yearly and progressive reduction of the non-Persian employees with a view to replacing them in the shortest possible time and progressively by Persian nationals.

(IV) *The Company* shall make yearly grant of ten thousand pounds sterling in order to give in Great Britain, to Persian nationals, the professional education necessary for the oil industry.

The said grant shall be expended by a Committee which shall be constituted as provided in Article 15.

ARTICLE 17

The Company shall be reponsible for organizing and shall pay the cost of the provision, control and upkeep of sanitary and public health services, according to the requirements of the most modern hygiene practised in Persia, on all the lands of *the Company* and in all buildings and dwellings, destined by *the Company* for the use of its employees, including the workmen employed within the territory of the Concession.

ARTICLE 18

Whenever *the Company* shall make issues of shares to the public, the subscription lists shall be opened at Tehran at the same time as elsewhere.

ARTICLE 19

The Company shall sell for internal consumption in Persia, including the needs of *the Government*, motor spirit, kerosene and fuel oil, produced from Persian *petroleum*, on the following basis:

(a) On the first of June in each year, *the Company* shall ascertain the average Roumanian f.o.b. prices for motor spirit, kerosene and fuel oil and the average Gulf of Mexico f.o.b. prices for each of these products during the preceding period of twelve months ending on the 30th April. The lowest of these average prices shall be selected. Such prices shall be the "basic prices" for a period of one year beginning on the 1st June. The "basic prices" shall be regarded as being the prices at the refinery.

(b) *The Company* shall sell: (1) to *the Government* for its own needs, and not for resale, motor-spirit, kerosene and fuel oil at the basic twenty-five per cent (25%); (2) to other consumers at the basic price with a deduction of ten per cent (10%).

(c) *The Company* shall be entitled to add to the basic prices mentioned in sub-clause (a), all actual costs of transport and of distribution and of sale, as well as any imposts and taxes on the said products.

(d) *The Government* shall forbid the export of the *petroleum* products sold by *the Company* under the provisions of this Article.

ARTICLE 20

(I) (a) During the last ten years of the Concession or during the two years from the notice preceding the surrender of the Concession provided in Article 25, *the Company* shall not sell or otherwise alienate, except to *subordinate companies*, any of its immovable properties in Persia. During the same period, *the Company* shall not alienate or export any of its movable property whatever except such as has become unutilizable.

(b) During the whole of the period preceding the last ten years of the Concession, *the Company* shall not alienate any land obtained by it gratuitously from *the Government;* it shall not export from Persia any movable property except in the case when such property shall have become unutilizable or shall be no longer necessary for the *operations of the Company in Persia.*

(II) At the end of the Concession, whether by expiration of time or otherwise, all the property of *the Company* in Persia shall become the property of *the Government* in proper working order and free of any expenses and of any encumbrances.

(III) The expression "all the property" comprises all the lands, buildings and workshops, constructions, wells, jetties, roads, pipelines, bridges, drainage and water supply systems, engines, installations and equipments (including tools) of any sort, all means of transport and communication in Persia (including for example automobiles, carriages, aeroplanes), any stocks and any other objects in Persia which *the Company* is utilizing in any manner whatsoever for the objects of the Concession.

ARTICLE 21

The contracting parties declare that they base the performance of the present Agreement on principles of mutual good will and good faith as well as on a reasonable interpretation of this Agreement.

The Company formally undertakes to have regard at times and in all places to the rights, privileges and interests of *the Government* and shall abstain from any action or omission which might be prejudicial to them.

This Concession shall not be annulled by *the Government* and the terms therein contained shall not be altered either by general or special legislation in the future, or by administrative measures or any other acts whatever of the executive authorities.

ARTICLE 22

(A) Any differences between the parties of any nature whatever and in particular any differences arising out of the interpretation of this Agreement and of the rights and obligations therein contained as well as any differences of opinion which may arise relative to questions for the settlement of which, by the terms of this Agreement, the agreement of both parties is necessary, shall be settled by arbitration.

(B) The party which requests arbitration shall so notify the other party in writing. Each of the parties shall appoint an arbitrator, and the two arbitrators, before proceeding to arbitration, shall appoint an umpire. If the two arbitrators cannot, within two months, agree on the person of the umpire, the latter shall be nominated, at the request of either parties, by the President of the Permanent Court of International Justice. If the President of the Permanent Court of International Justice belongs to a nationality or country which, in accordance with clause (C), is not qualified to furnish the umpire, the nomination shall be made by the Vice-President of the said Court.

(C) The umpire shall be of a nationality other than Persian or British; furthermore, he shall not be closely connected with Persia or with Great Britain as belonging to a dominion, a protectorate, a colony, a mandated country or other country administered or occupied by one of the two countries above mentioned or as being or having been in the service of one of these countries..

(D) If one of the parties does not appoint its arbitrator or does not advise the other party of its appointment within sixty days of having received notification of the request for arbitration, the other party shall have the right to request the President of the Permanent Court of International Justice (or the Vice-President in the case provided at the end of clause (B)) to nominate a sole arbitrator, to be chosen from among persons qualified as above mentioned, and in this case the difference shall be settled by this sole arbitrator.

(E) The procedure of arbitration shall be that followed, at the time of arbitration, by the Permanent Court of International Justice. The place and time of arbitration shall be fixed by the umpire or by the sole arbitrator provided for in clause (D), as the case may be.

(F) The award shall be based on the juridicial principles contained in Article 38 of the Statues of the Permanent Court of International Justice. There shall be no appeal against the award.

(G) The expenses of arbitration shall be borne in the manner determined by the award.

ARTICLE 23

(I) In full settlement of all the claims of *the Government* of any nature in respect of the past until the date of coming into force of this Agreement (except in regard to Persian taxation), *the Company:* (a) shall pay within a period of thirty days from the said date the sum of one million pounds sterling (1,000,000) and besides (b) shall settle the payments due to *the Government* for the financial years 1931 and 1932 on the basis of Article 10 of this Agreement and not on that of the former D'Arcy Concession, after deduction of two hundred thousand pounds sterling (200,000) paid in 1932 to *the Government* as an advance against the royalties and 113,403 3s. 10d. placed on deposit at the disposal of *the Government*.

(II) Within the same period, *the Company* shall pay to *the Government* in full settlement of all its claims in respect of taxation for the period from 21st March 1930 to 31st December 1932 a sum calculated on the basis of sub-clause (a) of clause I of Article II, but without the guarantee provided in sub-clause (b) of the same clause.

ARTICLE 24

If, by reason of the annulment of the D'Arcy Concession, litigation should arise between *the Company* and private persons on the subject of the duration of leases made in Persia before the 1st December 1932 within the limits allowed by the D'Arcy Concession, the litigation shall be decided according to the rules of interpretation following:

(a) If the lease is to terminate, according to its terms, at the end of the D'Arcy Concession, it shall retain its validity until 28th May 1961, notwithstanding the annulment of the said Concession.

(b) If it has been provided in the lease that it shall be valid for the duration of the D'Arcy Concession and in the event of its renewal for the duration of the renewed Concession, the lease shall retain its validity until 31st. December 1993.

ARTICLE 25

The Company shall have the right to surrender this Concession at the end of any Christian calendar year, on giving to *the Government* notice in writing two years previously.

On the expiry of the period above provided, the whole of the property of *the Company* in Persia (defined in Article 20 (III)) shall become free to cost and without encumbrances the property of *the Government* in proper working order and *the Company* shall be released from any engagement for the future. In case there should be disputes between the parties concerning their engagements before the expiry of the period above provided, the differences shall be settled by arbitration as provided in Article 22.

ARTICLE 26

This Concession is granted to *the Company* for the period begining on the date of its coming into force and ending on 31st December 1933.

Before the date of the 31st December 1933, this Concession can only come to an end in the case that *the Company* should surrender the Concession (Art. 25) or in the case that the Arbitration Court should declare the Concession annulled as a consequence of default of *the Company* in the performance of the present Agreement.

The following cases only shall be regarded as default in that sense:

(a) if any sum awarded to Persia by the Arbitration Court has not been paid within one month of the date of the award;

(b) if the voluntary or compulsory liquidation of *the Company* be decided upon.

In any other cases of breach of the present Agreement by one party or the other, the Arbitration Court shall establish the responsibilites and determine their consequences.

Any transfer of the Concession shall be subject to confirmation by *the Government*.

ARTICLE 27

This Agreement shall come into force after ratification by the Majlis and promulgation by Decree of His Imperial Majesty the Shah. *The Government* undertakes to submit this Agreement, as soon as possible, for ratification by the Majlis.

Made at Tehran, the twenty-ninth April one thousand nine hundred and thirty-three.

For the Imperial Government of Persia

(*Signed*) S. H. TAQIZADEH.

For and on behalf of the Anglo-Persian Oil Company, Limited,

(*Signed*) JOHN CADMAN, Chairman.
(*Signed*) W. FRASER, Deputy Chairman.

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